Federal Versus State Jurisdiction in American Life

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Social and Economic Consequences of Buying on the Instalment Plan

By

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FOREWORD

THIS volume contains the addresses delivered at a conference held under the auspices of the Academy in Philadelphia on October 29 and 30, 1926. The conference was attended by delegates appointed by the governors of many of our States as well as by many who represented educational institutions and other organizations.

The topic was chosen because of its outstanding importance for the American public. The relation between the Federal and the State governments is of necessity one that gives many opportunities for difference of opinion and that changes with the passage of time. There will always be disputes over the wisdom of having jurisdiction exercised by one rather than by the other governing body. Recently there has been a revival of the discussion which has suggested to many the arguments over States' rights so acute many years ago.

This problem has appeared in many fields and those in charge of the program for the Academy meeting decided to choose four specific illustrations and devote a session of the meeting to each. These illustrations were taxation, child labor, education and power development. The two evening sessions were of a general nature, dealing with a number of special phases of the general problem.

Every attempt was made to balance each program by securing representation for each of the important points of view. For the most part these efforts were successful, although in a few cases the balance was not so even as was desired. Any failure to present adequately the opposing views was due to circumstances beyond control.

The topics discussed are extremely important in American life and the contributors are so distinguished that the Academy presents the volume with satisfaction and with the belief that its publication will be a distinct service.

ERNEST MINOR PATTERSON,
Editor in charge of this volume.

Need for Readjusting the Fiscal System of the United States

By Edwin R. A. Seligman, Ph.D.
Columbia University

IN this series of discussions on the relations of the state and the Federal Government, there is one point that I should like to emphasize at the outset. It is this: that well-nigh all our modern political problems may be explained in terms of economic life. Although one need not be a devotee of the economic interpretation of history, there is little doubt that the economic conditions which surround the common man in his endeavor to make a living have from the beginning greatly influenced the political life.

This is especially true of the problem of the fiscal relations of state and Federal Government. For the attempt to take out of the pockets of individuals by coercive means a part of their wealth naturally strikes at the very nerve center of economic life. The relations between economics and finance are accordingly peculiarly intimate, and afford a clue to the understanding of the present-day fiscal problems, not alone in the states, but in the nation at large.

Following out this line of thought, let me recall to your mind the conditions as they existed when our present Constitution was adopted. For all of our problems, fiscal and otherwise, so far as the relations of state and Federal Government are concerned, are of course to be treated within the framework of our Constitution. No matter how beautiful a theory may be, no matter how admirable a plan may be, if it is unconstitutional, that settles it.

Impotence of Early Government

What took place at the time that the Constitution was framed? As we all know, when the colonies came together in order to make a common front against the foe, they had to struggle to survive those seven years of intensive strife. In the meantime, the Articles of Confederation were adopted. Under this loose union there ensued the difficult period which lasted for several years. The embarrassment arose from two sources. We have had many books written to explain the origin of our Constitution, but one of the chief reasons has never been emphasized. When a real history of the United States comes to be written, it will be found, without much doubt, that the troubles of 1767, the troubles of 1775 and 1776, and in like manner the troubles after the Treaty of Peace, were due to something that we are only beginning to understand, namely, the business cycle, the ups and downs of enterprise and of prosperity. Without going back to the earlier period which has never yet been thoroughly investigated, it so happened that during the eighties we were in the midst of a serious business depression which greatly intensified the difficulty of the situation.

The other and perhaps the main reason why we were not able to cope with the crisis was the impotence of the central government. When Robert Morris, the wealthiest man in Philadelphia, came to rescue us from our

troubles toward the end of the Revolution, and when he even put into the pot his own private fortune, he struggled in vain to persuade the states to grant to the Confederate Government an independent revenue; he failed and partly as a result of his failure to accomplish this, he resigned. Moreover, not alone did the central government have absolutely no power at home, it had also no power abroad. Several of the states sent embassies abroad in order to borrow money, thus competing with the central government. But above all, each of the new sovereign states looked out for its own separate interests, erecting all manner of interstate barriers, and throwing all kinds of difficulties in the way of the other states.

In other words, business suffered under a double handicap. We could not get a market for our products outside of the narrow confines of our own little locality, and we had, moreover, to cope with the additional difficulties of a business depression.

WHAT THE CONSTITUTION ACHIEVED

Fortunately there was one man that recognized the source of the trouble. You will remember Lafayette's statement in his later years that he had known many great men, including Napoleon and Metternich, Pitt and others, but that there was not one who could be compared in ability with Alexander Hamilton. Hamilton persuaded a few states to come together to consider commercial problems and out of that grew a wonderful convention and our present Constitution.

This Constitution was framed as a result of a great compromise on the basis of the existing economic conditions. Only a minimum of power was granted by the sovereign states to the central government. Certain things indeed were indispensable, as had been learned not alone in the Revolution, but in those dark years of the later crisis. Thus there was handed over to the Union first the control of the Army and Navy; second, the management of the Post Office, in order to maintain communication among the different states; and third, the control of the coinage.

These were the chief things which had been forced upon the country by the sad experiences of the war. There were, however, three or four other matters which the Convention thought it desirable to take away from the states, and which encountered no objection. The first was the control of the public domain. It will be remembered how immediately after, or even before, the treaty of peace, the separate states transferred to the Confederate Government, for the common enjoyment and the public good, all the outlying Western land which belonged to them under the original grants from the King. The control of the public domain now became a part of the Federal activities, and the hoped-for revenue from the domain was to be devoted to paying the national debt. In the next place the control of foreign commerce was turned over to the central government, and with it also the entire field of foreign credit. From now on, it became impossible for the states to borrow money abroad in competition with the Union. Then came the powers granted to the Union to control the economic relations among the states. This was really the motive force in the original efforts of Hamilton to revive the business life of the nation. Federal control over interstate commerce is the basis and secret of our economic prosperity. What we did was in effect to create a national market for all local productions—a market untrammeled by any restrictions or limitations. That is precisely what

they are trying to do in Europe today. It is the one great thing that has made this country what it is.

INDEPENDENT REVENUE FOR THE GOVERNMENT

Finally, the last object achieved by the new Constitution was the one for which Morris had striven in vain, an independent revenue for the new central government. Up to that time, all through the war and during the lean years after the war, the central government was supported, apart from the paper money and the loans from France and later from Holland, by contributions from the states, the so-called requisitions. The trouble was that Congress "required" the states to support the Union, but that the requisitions were not honored. The one indispensable need outside of the control over interstate commerce was to secure for the Federal Government an independent source of revenue.

While this explains the chief economic provisions of the Constitution let me call your attention to the fact that while most of the points represent exclusive rights, willingly handed over by the states to the Federal Government, two of them were concurrent privileges. Of these commerce was one. For the Federal Government received only the right to control interstate commerce, while intrastate commerce remained within the purview of the separate commonwealths. The second concurrent privilege was the matter with which we have specifically to deal, revenue. While the Federal Government was given an independent revenue, yet to only one thing did it have an exclusive right, taxation in the form of import duties. No state could impose a customs tariff. In all other respects, as to which nothing was said, we have to deal with concurrent rights of the states and the Federal Government.

In the one hundred and fifty years that have elapsed since the adoption of the Constitution, the economic life of our country has developed into something far different from that of the primitive community, the little agrarian economy with a sprinkling of people on the seaboard, with no industry to speak of, and with nine people out of ten farmers. As a consequence, the Constitution has been molded, either by change, through the process of amendment, or by the ingenious method of interpretation. The very first thing that was done was when Hamilton persuaded Washington to accept the principle of a national bank. Had the Federal Government the power to charter a bank? "No," said Jefferson, and repeated the Attorney-General, "There is no such grant of power in the Constitution." Then Hamilton invoked the doctrine which, in the hands of Marshall, revolutionized conditions in this country, the doctrine of implied powers. Since that time the control of banking has become one of the concurrent powers of government. We have had and still have Federal banks, as well as state banks.

In another respect also there has been a change. The states, learning by sad experience, after the yellow fever in Louisiana, after the cholera in New York, turned over to the Federal Government some of the control of public health, so that we now have a national quarantine and no longer, as before, a state quarantine. And so in other matters like bankruptcy, for instance, which do not come within our purview in this article.

INVOLUNTARY STATE RESTRICTIONS

There are only two points in which the powers of the states have been involuntarily restricted: the one, when

slavery was declared unconstitutional, and the other when the 18th Amendment was enacted. As to these points let me call your attention to the confusion that exists in so many minds today. We have been talking a good deal about governmental central rights, and state privileges. Until the 18th Amendment, however, every extension of central power, interpreted in economic terms, had to do with production. Even slavery, from the point of view of the South, was concerned with production. The significant change in the 18th Amendment, and the reason why it arouses so much opposition on the part of a growing minority in this country is that, for the first time in our history, the central power is extended to matters of individual consumption. That is the real reason why it is so resented. All other matters such as corporate control, power regulation, education, labor—all these deal, economically interpreted, with the question of production. In the 18th Amendment for the first time in our history the power of the central government was invoked to interfere with habits of consumption. This is essentially a return to medieval conditions, when government continually enacted its ill-chosen sumptuary legislation, deciding exactly what a man should or should not eat, drink, or wear. Modern life has brought us to the conception that there is something in the individual which should be sacred from such attacks. The endeavor to interfere with the personal habits of consumption is justified, if at all, only when, as in the case of opium, its continuance spells national disaster. No one can claim that temperance, that is a temperate use of drink or food, can lead to national disaster.

We must draw the line sharply between production and consumption. In problems of production, such as factory laws, child labor, corporate control, and the like, the minority will always give way to the majority and adjust itself to the prevalent opinion. But in the matter of consumption the individual will never give up what he considers his inherent rights as a separate being. We shall fail to reach a proper basis for the discussion of national prohibition until we learn to distinguish between the field of production, where a national minimum can properly be proclaimed, and the field of consumption, which it is utterly vain to hope to regulate by the exercise of national powers.

FACING FACTS IN A CHANGING ORDER

But whatever may be the truth here, the point which I desire to emphasize is that our Constitution as originally framed was a simple expression of the economic needs of the time. Have you ever reflected that the problems that confront us to-day are due to the fact that, when our Constitution was adopted one hundred and fifty years ago, economic conditions were different from what they are to-day, and that the constitutions of other Federal States, adopted under different economic conditions, vary in important particulars from ours? Why is it that our neighbors across the border, in Canada, have gotten along about as well as we do—certainly no worse—with an absolutely opposed constitutional theory? Our theory is that all powers not granted to the Federal Government are reserved to the states and the people respectively. The Canadian theory is that all powers not expressly granted to the states, or the provinces, are reserved to the central government. What the ordinary lawyer in this country still considers sacrosanct does not exist in Canada or in other parts of the world. Take the Australian Constitution, take the South African Constitu-

tion, and take, what is perhaps the most significant of all, the German Constitution, the new democratic, republican German Constitution forged as the result of the economic pressure of the Great War. What do you find? You find just the opposite of what you find here in the United States. You find things for which we are not ready and shall not be perhaps until we have another great war, an internal war. What would you think of a situation as in present-day Germany, where the central government has the power not only over marriage and divorce and labor and general legal conditions, but where all the important revenues are collected by the central government and then by it apportioned out to the states and localities? Conceive of that in this country! Yet, under the pressure of changing economic conditions, that was brought about in Germany because the sole way of meeting the reparations, which were a Federal obligation, was by centralizing all the powers in the imperial government.

What we need first and foremost is to rid ourselves of shibboleths, of prejudices, of prepossessions, the outgrowth of conditions of a century and a half ago. There is little use of saying, "We have got to obey the Constitution," if in the Constitution there are imbedded regulations which no longer respond to actualities. We do not practice obedience to either the 15th Amendment or the 18th Amendment. The only way to prevent us from degenerating into a lawless anarchistic people, as is fast developing in this country, is to conform your fundamental law to your economic facts. You cannot change the economic facts. No individual can, no government can. The only wise thing is to change your fundamental law so as to be in harmony with the new conditions.

TREND TOWARD FEDERAL TAXES ON WEALTH

What is the application of this to the problem of state and Federal revenue? Let us consider the stages through which we have gone in adjusting ourselves to these changes in economic life. At first, as I have pointed out, there was no Federal revenue at all. The Federal Government was supported by the states, which had all the sources of revenue. Then came the present Constitution, inaugurating a situation which down to the Civil War was unaltered with the exception of the short periods of war and of preparation for war. Well-nigh all changes in finance and taxation are due to war. In fact, fiscal science is sometimes called a war science; it is only now becoming a peace science. Most of the fiscal changes that we find in this country up to recent years have been due to war or the fear of war.

In the second period, which started in 1789, the Federal Government limited itself with two exceptions to a single source of revenue, namely, from import duties, while the states and localities employed all the rest. The exceptions occurred when we were threatened with war with France and when we actually had war with England. At those conjunctures, because of the necessity of securing more revenue than was derived from the import duties, we find, first, internal indirect taxes, which under the Constitution must be uniform, and which were now levied almost exclusively by the Federal Government. In the second place we find Federal taxes on wealth. I shall not stop to recall that great fight in the Constitutional Convention as to the provision making the assessment of direct taxes depend not upon wealth but upon representative population. I want simply to call attention to the

fact that during these anxious times a real estate tax and an inheritance tax were adopted; and had the War of 1812 lasted three months longer, we should have had the first income tax. For the Committee on Ways and Means reported in favor of an income tax; and although many of the framers of the Constitution were still living, there was not one who considered the income tax, in the constitutional sense, a direct tax. As soon, however, as the war was over, we find that all the powers of taxation save that exclusively reserved to the Federal Government, namely, import duties, were exercised solely by the states. For nearly half a century, there was a clear cut line of division between Federal and state revenues—import duties for the one, property taxes for the other.

Then came the Civil War from which we learned a great lesson. Had the other forms of taxation been in existence, had it been possible, in other words, to utilize an internal revenue at once and not wait a year and a half before the new machinery could be put in order, we should never have had the fiscal troubles which we encountered during the war; and we should in all probability never have been compelled to issue the greenbacks. As it was, we learned the lesson during the war, and by 1872, when all the war taxes had been abolished, we retained for the Federal Government internal duties on a few articles such as whiskey, tobacco and beer. Thus the third period witnessed the utilization by the Federal Government not alone of import duties, but of internal indirect taxes, while the great domain of direct taxes on wealth was still reserved to the states.

Finally came the changes brought about first by the economic development of the beginning of the 20th century, and then by the preparation for the Great War. We now find in Federal revenues direct added to indirect taxation. First, we had the Corporation Tax of 1909, disguised for constitutional reasons under the name of the Excise Tax. Next came the movement by President Taft to head off the impending income tax by recommending a Federal inheritance tax; and, finally, just in the nick of time for the war, came the adoption of the income tax.

As a result, we have entered upon the most recent period where the central government depends to only an insignificant degree upon import duties and to a slightly greater degree upon internal indirect taxes, but where it has come to rely principally upon direct taxes—the income tax and the estate tax. On the other hand, the states have not only kept the general property tax, but some of them have an income tax, more have an inheritance tax, and all have various forms of indirect taxes, such as taxes on transactions, on stock exchanges, and on certain raw products. They had, before the 18th Amendment, taxes upon liquor, and now they have almost everywhere the gasoline tax. In other words, both the Union and the states have come to depend on what are largely identical, or at least equivalent, sources of revenue—both direct and indirect taxes. This fact is responsible for most of our present-day problems. Let me in conclusion call attention to the chief considerations which must guide us in approaching a solution of these problems.

ADJUSTING FISCAL SYSTEM TO ECONOMIC FACTS

In the first place, let us face the situation as it is, and abandon the outworn shibboleths. Let us talk no more of states' rights; let us hear no more of the idea that certain revenues belong naturally to the states and that others belong naturally to the Federal Gov-

ernment. All this is belated. It belongs to the infancy of economic and political thinking. In view of the economic situation as it exists, how can we adjust our fiscal system to the economic facts? Here we are fortunately exempt from the necessity which confronts Germany. We do not have to meet a crushing external obligation, which overshadows everything else. But still we are not exempt from the imperious dictates of economic conditions. From that point of view there are three considerations that must guide us.

First, the principle of adequacy: how much money is needed by the states and the local governments as against the Federal Government? Second, the principle of efficiency: which will work better under actual conditions, a state or a Federal tax? Third, and most important, the principle of suitability: which tax is best adjusted to the underlying economic basis?

As regards adequacy, we thought at one time that Federal expenses would soon be almost negligible as compared to those of either the states or the localities and that the expenses of the Federal Government would continually diminish. But under war conditions and the aftermath of the war, it is different. At present we are spending for the Federal Government much more than for the states and almost as much as for the localities. And the prospects of permanently reduced Federal expenditures, in the four of the new methods of subventions to the states for roads and other things, are not especially bright. At all events, the problem of Federal finance once again looms large in actual fiscal life.

As to efficiency, there has been a decided trend toward centralization. Many sources of revenue which were formerly local are now controlled by the states because of the greater efficiency of centralized administration. It is a familiar fact that the chief progress in state and local taxes has been made in those states which possess state tax commissions with more or less centralized powers. And it is at least open to question whether up to a certain point at least the same considerations are not applicable to Federal taxation.

This brings up, however, the question of suitability. There are, of course, certain taxes which ought always to remain state and local in character. The real property tax, for instance, can best be levied by local assessors. Moreover, under the Constitution we cannot put a Federal tax on land because the tax would have to be assessed not on the value of the land, but according to the number of people in the state. If we had a direct tax on land, let us say in states like Massachusetts and Mississippi where the relative population is about in the ratio of two to one and the relative wealth in the ratio of seven to one, a tax on a farm of given value would be from three to four times as high in Mississippi as in Massachusetts. A Federal real estate tax, accordingly, is economically impossible.

Without taking up all the other taxes in detail, it may suffice to call attention to the fact that there are certain revenues, the source of which has developed from a local and a state basis to a national basis. Wherever an economic phenomenon which has become national in character is compressed within the mold of state control, we find the emergence of the problems of interstate income, interstate business, and interstate capital, which are vexing all of our commonwealths today. And when the conditions of ownership have transcended state lines, we have the additional problem of conflicting and overlapping state regulation, as in the modern inheritance tax with its duplicating, not to say triplicating, of burdens.

As to this, it is obvious that there is only one solution for such a problem. Where the economic basis has become national, the economic structure must perforce in the end be national. This does not necessarily mean that the revenue must be collected by the Federal Government; but it does mean that at least the control must be centralized. All this talk about state rights and naturally reserved revenues is unavailing. It is bound to disappear before the facts. We have already accomplished this result in one matter. The state taxation of national banks has been made uniform in this country because the decisions of the Supreme Court have enabled Congress to enact an appropriate law, which limits the activity of the states and which thus regulates the subject. We have not yet begun to approximate that result in the estate tax or the inheritance tax or the income tax or the corporation tax, but we are moving.

It is impossible to think that a practical nation like ours will continue forever to allow an out-worn political creed to interfere with business conditions and with justice in economic life. So far as the Federal and state revenues are concerned, what is slowly coming about, and what must of necessity come about in ever increasing measure, is a division whereby there will be left to the states and localities certain taxes which do not indeed politically belong to them but which for economic reasons are most suitable to them; and that there will be put under the control of the Federal Government, at first if possible through judicial decision, then, if that fails, through legislative regulation, and finally, if needed, through central administration, those sources of revenue which have a nation-wide economic basis, or which imperiously demand a uniformity of assessment and collection, in order to attain fiscal justice.

There is thus one lesson to be learned, which can never be overemphasized. Let us no longer be guided by the lawyers who so often look backwards, and whose hands are tied by effete constitutional traditions. Let us no longer listen to the politicians who weary us with their old slogans and out-worn shibboleths. Let us study the actual economic conditions, and especially the ownership and distribution of wealth as among individuals and classes; for these are the things of fundamental importance. The sooner we adjust our fiscal relations, today so badly confused, to those underlying facts, the better for all concerned. Vain is the hope of those who expect to stem the incoming tide and to roll back the torrent of new and impending economic changes.

Ways and Means Toward Equitable Adjustments of State and Federal Taxes

By W. B. Belknap, M.A.
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THE problem as to what should be the sources of state revenue and what Federal is not new. Any schoolboy knows that this question has been a difficult one from the American Revolution until the present day; nor will we solve it here nor will anyone else solve it anywhere else before the millenium. What perhaps we might do would be to lay down some generalizations as to what is a proper practical division in certain particular cases, or we might state some underlying theories, or we might do both, but the lasting importance of such pronounciamentos will be doubtful. What we may be able to do and I believe we ought to do is to try to discover a method of approaching these problems that will bring relief at such times as relief is needed.

The relation of state government to Federal government is a dynamic relation and its problems cannot be solved once and for all any more than the problems of life itself are capable of definite and final solution. For a general statement of state and Federal relationship we cannot do better than to read the now ancient words of Madison:

> The powers reserved to the several States will extend to all the objects which, in the ordinary course of affairs, concern the lives, liberties and properties of the people, and the internal order, improvement and prosperity of the State. . . . By the superintending care of these (the States), all the more domestic and personal interests of the people will be regulated and provided for. With the affairs of these, the people will be more familiarly and minutely conversant.

John Fiske, the historian, says:

> If the day should ever arrive when the people from the different parts of our country should allow their local affairs to be administered by prefects sent from Washington and when the self-government of the States shall have been so far lost as that of the Departments of France, or even so far as that of the countries of England, on that day the progressive political career of the American people will have come to an end and the hopes that have been built upon it for the future happiness and prosperity of mankind will be wrecked forever.

I believe these two quotations express the real creed of most Americans to-day concerning state influence. But in practical application they do not help much when applied to actual problems of state and Federal jurisdiction. Let's try for a more realistic method of approach.

What Are the Problems?

First, we must definitely see what the problems are. We know already that a conflict exists. This conflict is often spoken of as "between the Federal Government and the states." That is on the face of it a misnomer. It is a conflict between those who are generally spoken of as "states rights people" and those who believe in a greater centralization of power and activity at Washington. It sometimes becomes a conflict for jurisdiction between Federal officials and state officials. But we are all citizens of states and all citizens of the Federal Government and there is

no such thing as a federal government separable enough from the states to be in conflict with them. We cannot split ourselves into two citizens to fight against each other—one representing the state citizen and one the Federal citizen. The conflict we are to discuss is then a conflict of ideas and of theories within the body politic. The general acceptance of the matter as a "Federal versus State" matter forces us however to accept this nomenclature.

What is not generally recognized is that many if not most of the difficulties that arise in this connection are really difficulties as much of state being in conflict with state as with the Federal Government. This is often confused with the conflict between the states on one side and the Federal Government on the other. Very often it is a three-sided fight—the states against each other and they against the Federal Government. Perhaps the clearest examples of the intricacies of this type of conflict are to be seen in inheritance and income taxation.

When the death tax muddle was at its worst, as many as five different states might have claimed the right to tax one estate under certain given conditions. On top of this was the Federal Government tax one states. Theoretically the total taxes to be demanded from an estate might have reached a rate of something like 300 per cent. Furthermore, the tax laws of each state were different. The cost to the taxpayer of finding out what his taxes were was often more than the tax itself. It took waivers from seven different states to transfer one share of stock of a certain railroad from the estate of a decedent to a beneficiary. The settlement of an estate of any size could be and was often held up almost indefinitely by the questions arising from the settlement of the Federal tax. Three years was considered a normally short time within which to arrange the settlement of the Federal estates tax.

In this situation there was, then, unjust and uneven multiplication of taxes, great expense of payment and inexcusable delay of settlement. Nor were these troubles confined to the settlement of large estates. The evil was a very real one for all estates containing any securities. It was as good an example of a shameless fight for sources of revenue as could well be imagined. The several states claimed jurisdiction enough for tax purposes over estates upon every conceivable pretext—and the Federal Government also claimed this jurisdiction. The natural result was confusion worse confounded. In the language of the cowboy it was as bad as possible and continually getting worse. It was state against state and the Federal Government against them all. Evidently something would have to be done.

A CONTROVERSIAL SUBJECT!

Professor Seligman has suggested as a solution that we abolish all state inheritance taxes and leave the whole matter to the Federal Government.[1] When I first tackled the problem I was fully convinced that this was the right solution. If, like a late magistrate of Louisville, I had shut off discussion at that point I should have saved myself much puzzling thought and much mental worry. This said magistrate in a certain case informed the lawyer for the defense when he arose that he could sit right down, he didn't want to hear any more. He had heard the plaintiff and made up his mind and it only confused him to hear both sides of the question. I think at times we have all felt the same way whether or not we have been honest enough to admit it.

[1] See p. 1.

Later, when I had studied the states' side of this question for a couple of years, I turned the other way around and stood side by side with the gentleman from Rhode Island, Governor Bliss.

In the first place, I saw that from a practical point of view it was going to be a political impossibility to get through a constitutional amendment forcing the states to relinquish the necessary power to the Federal Government. In the second place, if there was one logical branch of the government to collect this tax, it was the branch that had jurisdiction over the settlement of estates of decedents—namely, the state government. And again, there were certain states whose financial development had been such as to make this tax an essential part of their revenue. It was not an essential part of the revenue of the Federal Government. The states controlled the proper machinery of collection, *i.e.* the probate courts. Again, they had no available substitute for the yield from this tax as a source of revenue.

Those who advocated the Federal Government as the sole collector of death taxes usually favored a nebulously stated return of part of the money to the states. They were never able to offer a satisfactory formula for just how the share going to the states was to be apportioned. Were taxes from real estate to go to the state of situs; taxes from securities, partly to the state of domicile, partly to the state of incorporation, and partly to the state of situs of the property of the corporation? A mere reading of these questions will show how impossible it would be to answer them satisfactorily. By turning the collection over to the Federal Government, these questions would not really be settled; they would simply be transferred to a different battlefield. They would cause log rolling and bickering in Congress between states for all time to come. Each state would be forever jockeying to get more of the proceeds.

The impossibility of abolishing the state taxes was evident, but so was the impossibility of having the chaotic condition of this tax continue. It looked at this time as though the proper solution was the reform of the state taxes and the abolition of the Federal tax.

Then came the disturbing element which so often enters into these problems of jurisdiction—cut-throat competition between the states. Florida, in an effort to advertise the fact that she had no death taxes, passed what was under the circumstances an almost meaningless constitutional amendment. It simply said she never would have. Certain other states followed suit or were preparing to follow suit. Very evidently this establishment of havens of refuge for the rich would take most of the yield from the inheritance tax in those states that were dependent upon the revenue. Very evidently the states were not going to yield to the Federal Government sole power in death taxes; Florida was not going to be enthusiastic about any plan which robbed her of this pet publicity item. States dependent on this source of revenue, like New York, could hardly be expected to do so. That solution on the face of it was out of date. Equally true was it that simply abolishing the Federal estates tax would not have helped the evil of the overlapping state taxes. It would not have cured the newly recognized evil of unfair competition for wealthy residents but would have aggravated it.

SETTLING INHERITANCE TAX PROBLEM

It was at this juncture that President Coolidge suggested to the National Tax Association that it call a confer-

ence in Washington. Delegates came from most of the states and from a number of the universities. The President himself addressed the assemblage and so did a number of members of the Ways and Means Committee of Congress. The difficulties of the situation were thoroughly pointed out and a committee was appointed to work on these problems. This committee drew up a model law for the states, it cooperated with the Ways and Means Committee in working out a reasonable rate for the estate tax and suggested the present eighty per cent deduction from the Federal estates tax for state inheritance taxes paid and urged upon the states that they do away with the non-resident taxes.

The fixing of the Federal deduction in such a way as to allow the states to take a fair tax without penalizing estates, has tended to standardize state rates; and whether or not rates are standardized among the various states, estates of the same size will in most cases pay approximately the same tax regardless of whether the former owner was a resident of Florida or of New York. This solution has left the states the right of self-government, but above all it has prevented the confusion that was bound to result from the unfair competition for the favors of wealthy residents.

Along with the Federal deductions allowed for state taxes has come a very gratifying response to the demands that the non-resident taxes of the states be either eliminated or made as unobjectionable as possible. This recent adoption of more intelligent laws with regard to non-resident estates has come largely in response to the efforts of Senator Edmonds. Along with this the courts have thrown out some of the objectionable acts, and those of us who have been interested in the subject feel greatly encouraged at the outlook. We feel that state inheritance taxes have been reserved for those states that need them; that the Federal revenues will benefit in the cases of states who do not; that a mild coercion on the part of the Federal Government bids fair to serve our purpose; that we are using intelligent means of settling the conflict instead of resorting to the Club of Centralized Power.

The reasons for going so extensively into a subject not of supreme interest to everyone generally, is that the methods used in this case of the inheritance tax muddle can well be used in other cases of conflicting jurisdiction between the various states and between them and the Federal Government. This method will not, of course, be infallible —nor is it always applicable. In cases where states persist in unfair competition, whether in bidding for incorporation fees or for divorce proceedings or for sources of revenue, it will become necessary—after all other means fail—to centralize in the Federal Government the power requisite to bringing order out of chaos.

Where a reform sought is one in which honest differences of opinion occur in different states or different sections either as to aim or methods, then each state or each section should be allowed to work out its own salvation so long as it does not trespass too severely upon the rights of the other states. And we should not force upon the country the supposed cure-all of centralization of power.

Most problems of jurisdictional dispute over which there is much discussion belong to one or more of three classes; either

(1) where there is general agreement between the states and the Federal Government as to the object sought, but where the mechanical means of accomplishment are difficult, or

(2) in the class arising from unfair competition between the states, or

(3) in the class of problems arising from some sections of the country or of some groups trying to force their ideas upon other sections or groups by means of centralization of power.

There will always be, of course, a number of border-line cases. Reforms of the first class, where there is agreement of aim, lend themselves to the conference method of solution most easily. The same method may in many cases find ways of overcoming unfair competition by convincing the offending states of the errors of their ways. Again, the conference method, by turning on the light, is very apt to make it evident whether or not the discussed reform is one that had better be left to the states themselves. The borderline cases will be the most difficult to deal with.

The problems of jurisdiction with relation to sources of revenue fundamentally differ but little from other problems of jurisdiction. In many of these problems—as in inheritance taxation—there is no one right solution. If we try to be fair and at the same time practical we are bound to compromise. If through centralization of power we force upon the country the will of either a tyrannical majority or of a powerful and determined and overreaching minority, we are either going to choke the genius of local self-government or we are going to cover up smouldering fires that will eventually destroy our union. Compromise is apt to be best achieved by friendly conference of those interested.

As I have said before, my idea is that what we should be interested in is not just tagging certain sources of revenue as belonging to the Federal Government or the state governments—not in just allotting certain jurisdictions theoretically to one or the other—but that we suggest some intelligent method of attacking such problems, each on its merits, and according to its peculiarities. I have described the method used recently in inheritance taxation. This is not the only way such things can be done. But it looks promising.

AID OF NATIONAL ORGANIZATIONS

It will pay us to note the growth in importance of the Governors' Conference, of the National Tax Association, of the Committee on Uniform State Laws, of the Law Institute, the League of Women Voters and of the legislative committees of such bodies as the American Banker's Association, the American Medical Association, the National Education Association, the National Conference on Social Work, the National Highway Conference and the National Real Estate Association, and other similar bodies.

The Governors' Conference meets every year and gives the state executives a chance for friendly discussions of their public troubles and explanations of their aspirations for their states.

The National Tax Association has an annual conference. It is composed largely of state officials—but also contains all of those enough interested in public finance to attend its meetings.

The Committee on Uniform State Laws is made up of delegates from each state appointed by the governor of the state and works in connection with the American Bar Association. It has accomplished much but its work is little more than started. Much of its work is naturally quite technical in character, *e.g.*, the now generally accepted Negotiable Instruments Act.

The Law Institute, also a child of the American Bar Association, is engaged upon a re-draft of the common law that

will tend to bring about state uniformity of interpretation of the common law. The importance of this can hardly be exaggerated.

Recently we had organized a very significant body—the American Legislator's Association. This body is composed of delegates elected by the legislators of each state. It is to meet annually at the same time and place as the American Bar Association. Among other things, it plans to work with the Committee on Uniform State Laws. The first meeting was in Denver this summer. Anyone who has ever served in a legislature has seen the carelessness with which most legislation is prepared for passage. In fact, when one realizes the lack of consideration given to the larger aspects of most bills, it becomes evident what a great influence for good is possible to such an organization as the American Legislator's Association.

I do not predict but I do suggest and hope that out of this wealth of organization may grow a more formal and more powerful body;—a body for conference and compromise—perhaps official, perhaps semi-official—that, working through functional committees much as the Inheritance Tax Committee worked, shall use intelligence and accumulated experience and knowledge in solving these problems of jurisdiction. Such a body would give attention perhaps to general theories but largely as these were necessary to solve specific problems. It would give the states a chance to pass intelligent laws carefully drawn up and openly discussed in friendly conference.

This would preserve to the states the freedom of action that has allowed them to remain a union in spite of widely differing traditions, populations and institutions. It would avoid the destruction of the genius of self-government within the states and would preserve state governments for the time when our population has grown to the point where some sort of integration would be an absolute necessity. And this latter is a very important consideration.

Some people feel that we are already overorganized for Reform with a capital R. Arthur Guiterman has expressed this most ably in a poem entitled

DAMMING THE MISSOURI

Once a company of Beavers in their engineering fury
Took a notion that their mission was to dam the Big Missouri:
Under Consecrated Leaders they assembled in Convention
For the instant prosecution of their laudable intention.
They were able hard wood biters, they were doughty timber topplers,
And they beavered down the willows and they felled the heavy poplars,
And they laid them to the riffle and were very, very clever,
They were brilliant! Yet the river paid them no regard whatever
But through barrens dry and sandy, or through marshes wet and drippy
Went on flowing, flowing, flowing to the Mighty Mississippi.

When we try to curb the surges of unchanging human nature,
Or to quench a conflagration by an act of legislature,
Or to stem a revolution by the words of quiet thinkers,
Or to hold religion static in a martingale and blinkers,
Or to turn the silent current of continuous creation,
Or to cork the effervescence of a rising generation,
Or to stop the zealous doctors from inventing new diseases,
Or to keep a wife from doing just exactly what she pleases,
We are every bit as crazy, as I'll prove to any jury,
As those enterprising Beavers when they dammed the Big Missouri.

Perhaps this is an age of organization, of over-organization. It is, however, the duty of those of us interested in maintaining our government on the highest plane to work through our own particular organizations for intelligent solutions of vexing problems and not allow this or that body, organized for selfish or emotional propaganda, to stampede legislatures and Congress into a stupidly wholesale centralization of power. I believe we should seriously consider the advisability of working toward some such conferential body as I have suggested. A formal body half way between Congress and the legislatures, a liaison organization capable of collecting data and making dispassionate investigation and recommendations, could be of tremendous value in preventing undue centralization of power and in maintaining the priceless heritage of our present state governments. It would solve our problems by intelligence rather than by propaganda and force.

Federal Co-operation in State Sources of Revenue

By Hon. Mark Graves
Commissioner, New York State Tax Department

USING my own experience in public life and what I have observed therefrom as a guide, the first thought that comes to me in relation to the subject of Federal and state sources of revenue is this: The founders of our government seem to have planned it this way, that things which were of national importance should be functions of the national government; that those which were of state import should be functions of state government, and those which were concerns of localities should be functions of localities. We raise taxes to pay the cost of government, and the cost of government in the aggregate for a specified group of municipalities, whether they be local municipalities or states, or the cost of the national government itself, depends upon the functions which those different governmental units perform.

Professor Seligman has developed the thought that in the past one hundred and fifty years great and powerful forces have been operating in this country, that our country has changed from one where primitive conditions existed to one which is highly developed in an industrial, social and economic sense.[1] The change from primitive conditions to a highly organized state has naturally brought about, first, a multiplication of governmental functions, and second, a shifting of them. At the bottom of the scale, we find local governments exercising functions today which in the beginning were matters of private concern. I refer to charity, education, and a lot of kindred subjects. Things which formerly were of local concern, and therefore local functions, and paid for by the localities, have become state functions, many of them. Some of them have even grown into matters of national importance.

Shifting Process in Government

The point I wish to make is that functions of government are continually and constantly changing and that as they shift and change revenue requirements change with them. The proposal to assign to the Federal Government certain sources of revenue and to the states and their localities other objects of taxation, makes a plausible appeal to one's reasoning. It would be a desirable thing to do if it could be done in such a way that each taxable ability would contribute toward the aggregate cost of government in this country on a relatively equal basis. Frankly, I think the proposal is too idealistic, and I am convinced that it is wholly impractical for a variety of reasons.

The national government should not be limited or restricted in times of war and during periods of payment of war debts. It is just as essential that the Federal Government have the power to marshal the revenue resources of the country in times of national emergency as it is to command the industrial, financial and man power of the country. And when a war ends, it is equally important that the national government have the authority to raise by whatever means is best the revenue necessary to pay the war debt.

The constant shifting of individual

[1] *See* p. 1.

efforts for the common good to the sphere of governmental activity, and the transition of local functions to the position of state and national concerns, make it impossible to adopt any segregation of sources of revenue either permanently or temporarily for any considerable number of years.

Even though this shifting process did not occur, there is no assurance that yields of revenue from assigned sources would increase in substantially the same proportion as the activities of the different governmental organizations increase.

SECURING ADEQUATE REVENUE

The outlook is that for the next few decades the most difficult problem in government finance will be that of securing adequate revenue for American municipalities. They now have but one main reliance—the tax on property. And they can ill afford to have assigned to the national government for its exclusive use any source of revenue of high productivity, as, for instance, the income tax. It seems clear that in the older states, highly organized industrially and socially, the design must be for the state to take over some of the local functions and finance them, or devise means of raising revenue on a state-wide basis, and then distribute it to the localities.

I think we may agree that a revenue law which can be administered nationally but which cannot be administered by smaller units is a proper source of revenue for the Federal Government; and, conversely, that a revenue law which can be properly administered by local governments but not by the national government should be a source of local revenue.

The Constitution gives, as it should because of the impossibility of administration by states and localities, to the Federal Government the right to lay duties on imports. The direct tax on property, while not specially reserved to the states and their localities, has in actual practice, except in isolated cases, been recognized as a source of state and local revenue, and for practical reasons is not available as a source of national revenue. This, in my opinion, is as it should be. Likewise, the states have generally left the field of indirect taxes on specified articles and luxuries to the Federal Government. And this has undoubtedly been wise procedure.

INCOME AND INHERITANCE TAX FIELD

The two sources of revenue now utilized by the Federal Government and to a considerable extent by state governments are the income taxes on individuals and corporations and the inheritance tax. It seems then that any proposed division of sources of revenue would be likely to revolve around these taxes.

The suggestion has been made that the states abandon to the Federal Government the income tax field and that the Federal Government release to the states the inheritance tax field. I am convinced this would be an unwise and inequitable division. Income as a source of taxation has great revenue-producing possibilities. I am constrained to believe that we may obtain in this country as much or more revenue from this source than we have from the direct tax on property. Except in times of war and in the periods when war debts are being paid, the need of the states and of their localities for revenue is greater than that of the Federal Government. Indications are that local demand will increase at an accelerated rate. If then this great source of revenue is given exclusively to the Federal Government, it is entirely likely to happen that those taxed on this base will be taxed relatively

lower than those taxed on their properties for the support of state and local governments.

The inheritance tax has not the revenue-producing possibilities of the income tax. If that field of taxation were abandoned by the Federal Government, the revenue possible to be derived by the states would be inconsequential in comparison with actual needs and requirements.

FEDERAL GOVERNMENT AND ESTATE TAX FIELD

One of the writers in this volume has alluded to the Federal Estate Tax.[2] He takes the position advocated by many others, that the Federal Government should retire from the estate tax field. I agree with Governor Bliss that the states have a higher legal and moral claim to this source of revenue than has the Federal Government, but I differ with him on the desirability of having the Federal Government withdraw. I differ for very practical reasons. We must recognize that in the inheritance or estate tax we have a tax which is levied but once during the lifetime of an individual. We should realize that in this country state inheritance taxation is in a chaotic condition. There is utter lack of uniformity; states have been striving apparently one to outdo the other in their efforts to reach all of the property over which they can claim any right to levy a tax. To remedy that sort of a situation we all agree that intangible personal property of a non-resident decedent should not be taxed; or, to state it conversely, that the decedent's intangible holdings should be taxed only in the state of his residence, meaning the state of his residence at the time of his decease.

Statistics show that about two-thirds of the assets of taxable estates consist of intangible personal property, at least that is what our statistics in New York show. So we have the condition that, if we bring sense into our state inheritance tax statutes, the decedent's estate will be taxed at least in respect of two-thirds of the assets in the State of which he happens to be a resident at the time of his death, without reference as to where he may have lived all the other years of his life, or to what influences he owes the accumulation of his wealth. Many of us believe that the inheritance tax is a good tax; it is found in all democratic countries. It plays a rather prominent part in the social and fiscal plans of all civilized countries. Therefore some of us believe that the Federal Government should remain in the estate tax field in order that we may preserve this very good tax. You may say, "Why is it necessary for the Federal Government to remain in this field in order to preserve this tax?"

Well, I will tell you, very briefly, why, as we see it. A few of our states, Florida, Alabama, Nevada and the District of Columbia, have no inheritance tax statutes of any kind. They offer havens of refuge for people of great wealth; by the simple expedient of taking up their residence there, they can avoid any inheritance tax at the time of death. Keep in mind that this is a tax that is not paid annually, but paid once during a lifetime. A man, after accumulating a vast fortune, might select one of these havens of refuge in his latter years, and thereby avoid all inheritance taxation if the Federal Government should retire from the field.

Now if this is a good tax, if it is desirable that we secure some substantial amount of revenue from this source, we are justified, I believe, in adopting practical methods of preserving it.

[2] *See* p. 21.

The person who accumulates a fortune or who acquires any substantial amount of property does not do it because of the laws of any particular state; he is enabled to do so by the opportunities which the laws of all of the states and of the national government itself afford him during his lifetime. If we could successfully impose an inheritance tax upon the estate of a non-resident decedent, representing his investment in property within the several states—if that were practical of accomplishment —we might very well say that if the State of Florida does not wish to impose an inheritance tax that is her business and no concern of ours, and is no reason why the Federal Government should remain in the inheritance tax field. But the converse of that is true. If we are to have sensible inheritance tax legislation in this country, we must tax real property, in the state where it is situated, tangible personal property in the state where it has a situs, and all other personal property at the residence of the decedent, at the place where he resides at the time of his decease. It is for these very poorly stated reasons which I have enumerated and others which space does not permit me to state that some of us believe the Federal Government should remain in the inheritance tax field and with the eighty per cent credit provision as now contained in that statute.

Someone may say, as Governor Bliss indicated, that the effect of such a law will be to excite and persuade states to take advantage of the eighty per cent provision. My honest conviction is that if that is done and if that state has no need for the revenue which it receives, it will find, if it surveys its tax system and the tax systems of the local governments within the state, places where taxes may be reduced, and this excess revenue used to take up the slack.

All this talk about the usurpation by the Federal Government of the taxing power of the states, of using a club to force states to have inheritance tax laws, and of state rights in this relation is just plain unadulterated piffle.

The point at issue is: shall we break down inheritance taxation in this country? Active and apparently powerful influences are at work to accomplish that end. They are opposed to this tax for very selfish reasons. They know that if they can bring about the repeal of the Federal estate tax, rivalry and competition between the states will whittle the revenue from this source down to almost nothing. If that could be done without shifting the deficit to the shoulders of already overburdened realty and income (personal and corporate) taxpayers, we would welcome the plan. But when we see that the result would be to place heavier tax loads on the farmer, the home owner, the rent payer and business of every description, we are impelled to voice opposition to the "scheme" and I use that word advisedly. Of course many of those who favor the repeal of the Federal estate are well intentioned. They are carried away by the "states' rights," or some similar argument and are just being used by those who have selfish interests at stake.

PROBLEM OF COMING GENERATION

As I have said, the problem of this and the next generation will be that of financing our local governments. Local governments now receive almost all their revenue from a tax on property —and when I say a tax on property, I mean real property, almost entirely real property. Moreover, as I see the situation, functions of local governments will increase and grow more rapidly in the next generation than will the functions of the state and

national governments. One of the problems which I believe the states must face in future years is that of financing their localities. I doubt if there is any state in this Union of which you can safely say they have no need for inheritance tax revenue. It may be they are getting along without it, but if so, I think you will find it is because of heavy burdens placed on some other objects of taxation. I hope to see inheritance taxation in this country developed. We never have received more than say $200,000,000 from that source for Federal and state purposes. In England, with a national income of a third of ours, they collect more from this source. I believe that the inheritance tax can be developed into a source of revenue which will produce five, six, seven or possibly eight hundred million dollars yearly. Bear in mind that if we obtain $500,000,000 from inheritance taxes, it means that so much less will be levied on property or income or business. I believe that we can develop this tax in this country to the point where it will be a material revenue producer, with the result that other taxes may be lowered or prevented from going higher.

Why Federal and State Bases of Taxation Should Be Separate

By Zenas W. Bliss

Chairman of the Rhode Island Board of Tax Commissioners

I SHALL speak from the standpoint of a state tax official, and shall endeavor to indicate some of the difficulties which we now have because the Federal Government and the states are using the same tax bases from which to derive a part of their revenue; and I shall call attention to others which seem to me to be imminent, and which I think will soon be upon us unless proper steps are taken to avoid them.

We are all familiar with the situation with respect to our inheritance and estate taxes. Conflicting jurisdictions, a lack of uniformity in the laws of the several states and the Federal Government, a tendency on the part of some to use this method of taxation for the purpose of influencing the acquisition and determining the distribution of wealth rather than as a measure for raising revenue, and the attempts of others to impose this tax upon all the property that can possibly be reached regardless of the residence of the decedent, the situs of the property, or the equities involved—all these have brought about a situation which leads many of our citizens to regard this old and formerly respectable tax not as a tax at all, but as an added terror to the pangs of dissolution.

The first application of this form of taxation in the United States was by the Federal Government in July, 1798, about eighteen years after its introduction in England. Pennsylvania, twenty-eight years later, or in 1826, was the first state to impose an inheritance tax. The other states followed at varying intervals until practically all of the states imposed some kind of an inheritance or estate tax. I mention these facts merely to call your attention to the circumstance that the Federal Government was first in this field of taxation and was followed by the states.

It is also a fact that the Federal Government abandoned this form of taxation for a considerable period, and, before it seriously reëntered this particular field, inheritance and estate taxation had become an important element in the fiscal policy of many of the states. Inheritance and estate taxation is now highly developed and a very important factor in the revenue systems of a great majority of the states. Under these circumstances it is natural that the states should consider this field of taxation as peculiarly their own, and should look upon Federal activity therein as an encroachment upon their rights. Technically, of course, this view is not correct; there is no question as to the legal or constitutional right of the Federal Government to employ this form of taxation; but as the states have developed this tax in many instances to a high degree, and as the Federal Government had apparently decided to abandon it altogether, or at the most intended to use it only as an emergency measure, there is a certain justice in the claim of the states that this field should be left entirely to them, and in this I heartily concur.

FEDERAL ADMINISTRATIVE DIFFICULTIES

I have never considered inheritance or estate taxation a proper field for the Federal Government, and so far as I have been able I have always opposed it. There are difficulties of administration which seem to me insuperable, because of our wide geographical extent, the uneven distribution of wealth, and the great dissimilarity in the economic organization and social life of the different sections of our country.

It is by no means an easy matter to frame an inheritance or estate tax law that will give satisfaction even within the comparatively restricted jurisdiction of a state. To formulate a Federal law that will not be unpardonably sectional and at the same time be simple enough to be practical from the standpoint of administration, is extremely difficult.

As an illustration of the difficulty of applying the same law to two widely separated states differing materially in their ecomomic and social organization, I will cite Rhode Island and Mississippi.

In 1916 Rhode Island passed an estate and inheritance tax law. This law has operated with a marked degree of success up to the present time. The amount of revenue raised is adequate. The rates, with two or three minor exceptions, are the lowest, I think, imposed by any of the states, and the exemptions are comparatively high. There has been practically no litigation, and the cost of administration has been low.

This Rhode Island law was copied almost verbatim by Mississippi. The rates were increased somewhat and the exemptions lowered, and there were minor changes made in the officials administering the law, but there was no change in theory or the fundamental principles involved. I have reason to believe that the administration was intelligent and energetic, but the law was a failure in Mississippi. It did not produce sufficient revenue, it was extremely unpopular, there was a great amount of litigation, and the law was finally repealed and replaced by another based upon an entirely different plan, which I understand is working fairly satisfactorily.

It is, of course, necessary to appraise the property of all estates coming under the provisions of the Federal estate tax law. So far as stocks and bonds with a wide market are concerned this is a simple matter, but when real estate, tangible personal property, the securities of close corporations, partnership interests, receivables and similar values are involved, a proper appraisal can be made only by those familiar with the locality and the several classes of property passing, and they must also have a substantial and comprehensive knowledge of business and social conditions in the particular locality in which the property and business happen to be situated.

If these conditions are to be satisfactorily met it will require a very considerable number of appraisers, and their sphere of usefulness will be necessarily limited. It is impracticable to maintain any such corps of appraisers, and consequently the valuations in many instances are bad. Accuracy of valuation must necessarily be sacrificed to economy of administration. Furthermore, if the taxpayer feels himself injured and that it is necessary for his protection to appeal to the courts, he finds litigation very expensive, and it frequently happens that he submits to what he considers a rank injustice rather than meet the cost of such litigation.

I shall not further trouble you with specific objections to the Federal estate tax from the administrative standpoint. It is worth noting, however, that the revenue yield is comparatively small, and it will not seriously

deplete the Federal treasury if this source of revenue is abandoned. On the other hand the receipts from estate and inheritance levies form an important part of the revenues of many states, and cannot be foregone without throwing out of adjustment their systems of taxation.

EIGHTY PER CENT CREDIT CLAUSE

In addition to the foregoing there is a much more objectionable feature of the estate tax provision of the Federal Revenue Act of 1926—an unsound, dangerous principle, it seems to me—the eighty per cent credit clause, as it is generally called. This clause provides in substance that the amount of estate and inheritance taxes assessed by and paid to the state may be used by the taxpayer as a deduction against the Federal estate tax up to eighty per cent of the amount of the Federal tax.

The effect of this provision is apparent. Unless the several states adjust their rates to conform to the Federal rates, and thus impose a tax equal to eighty per cent of the tax imposed by the Federal Government, the states will lose the difference between the amount they assess and eighty per cent of the Federal levy, with no resultant saving to the taxpayer. In any event the taxpayer pays an amount at least equal to the amount of the tax assessed by the Federal Government; it is merely a question of distribution. It is immaterial to the taxpayer; his contribution is not affected.

Whatever may be the avowed purpose of this clause, and no matter how sincere its framers and advocates may be in claiming beneficial results to be brought about through interstate comity (and these claims have been justified to a certain extent at least), the fact remains that the states have been coerced or cajoled into altering existing or enacting new laws to protect themselves against, or to take advantage of, the eighty per cent credit clause.

I am very much in favor of interstate comity and uniformity, within limits, in estate and inheritance tax laws, for I believe that many of our present troubles, annoying delays, multiple taxation, excessive combined rates, and the necessity for filing numerous complicated returns, will be very substantially reduced if not entirely eliminated by hearty co-operation between the states. I am convinced that uniformity in principle, uniformity in determining the situs for taxation of the various classes of intangible property and such matters, will be beneficial, but from such experience as I have had and such investigations as I have been able to make I am not convinced that uniformity in rates is either desirable or feasible. The conditions prevailing in the several states are so diverse that if the same rate happened to fit exactly the situation in several widely separated states it would be nothing more or less than a remarkable coincidence.

The Rhode Island law was amended to conform to the Federal rates in order to take advantage of the eighty per cent credit clause. It was necessary to increase the rates in the upper brackets approximately five hundred per cent and it was estimated that the revenue from this source would thus be increased approximately three times. This increase was not needed by the state, and would have thrown our whole revenue system out of adjustment by the imposition of an unnecessarily high capital levy, but we took care of the anticipated increase by providing that all revenue received beyond that which our former rates (with very slight changes) would produce should be set aside for specific purposes. I may say parenthetically that this estimated increase in revenue has not yet appeared. I do

not know whether this is due to the fact that the new rates have not been in operation for a sufficient length of time to demonstrate what they will do, whether our calculations were incorrect, or whether our multimillionaires neglect or refuse to die in accordance with our experience tables.

So far as Rhode Island was concerned the purely fiscal consideration involved was not serious. There is, however, what seems to me a very serious aspect to the situation. The Federal Government by the enactment of the eighty per cent credit clause is attempting to regulate local taxation. The provision was apparently very carefully thought out, and without going into details I think the provision is constitutional and enforceable. However that may be, the Federal Government, by means of this eighty per cent clause, in my opinion, employs an agency and inaugurates a policy of intervention in matters of purely local concern that should be opposed by every state in the Union as an encroachment upon, and an unjustifiable and impolitic interference with, local self-government. It seems perfectly apparent to me that this policy, if carried to its logical conclusion, would make state governments practically if not actually impotent to manage their own financial affairs in accordance with the desires of their citizens.

The bad features of the estate and inheritance tax to which I have briefly called your attention—conflict of jurisdiction, use for purposes other than raising revenue, and lack of interstate comity—are not peculiar to estate and inheritance taxes alone. These bad features will be encountered to a similar extent in practically all cases where the conditions are comparable, no matter what kind of a tax is involved. Whenever the Federal Government and the several states tax the same base, or there is an opportunity for two or more states to tax the same thing, there will be a tendency to abuses similar to those which now exist with respect to estate and inheritance taxation.

ROCKS AHEAD

I fully appreciate the dangers of wandering into the domain of prophesy, particularly with respect to taxation, but nevertheless I anticipate that in the not very remote future a number of states will impose income taxes, as some already have; and I also anticipate difficulties of a similar character and quite as serious as those we have experienced with estate and inheritance taxes. Double taxation with respect to all of the income, and multiple taxation with respect to certain classes of income, may easily result in a combined rate sufficiently high to bring about very serious sociological results, undesired by any of the several jurisdictions imposing the taxes. There is always this danger when two independent jurisdictions tax the same base, and of course the danger increases as the number of taxing jurisdictions and the chance for higher combined rates increases. In fact, it seems to me that the possibilities for bad results are considerably greater with respect to income taxation than they have proved in estate and inheritance taxation. We have, however, the great advantage of experience, and we should certainly avail ourselves of it, and by so doing avoid as many of the pitfalls as possible.

I venture to assume, notwithstanding the prominence which the discussion of a certain later amendment has attained, that many of you remember the agitation in favor of the 16th Amendment to our Federal Constitution, and what great stress was laid upon the advantages to be derived from a direct tax upon incomes. Income was the true measure of ability to pay, and

ability to pay the best basis upon which to levy a tax. Income was more widely distributed than property, and as the tax was a direct tax, it would fall upon and be felt by many who were heedless of the considerable amount of indirect taxes they were paying, and the result would be, of course, a general interest in the cost of government, and the general public would become aware of extravagance and would demand that it immediately cease. Paying a part of their incomes directly into the Federal treasury would stimulate all to give heed to public affairs, and much good would result from this widespread awakening of the citizens to their civic duties.

Nearly thirty years in the public service has made me somewhat pessimistic with respect to constitutional amendments in general, and this amendment certainly fell very far short of the hopes and expectations of its advocates. Several quite important matters were overlooked, or at least unheeded, and these matters are of particular importance in a consideration of Federal and state sources of revenue.

TENDENCY TOWARD MINORITY TAX

It is well to bear in mind that those exercising the taxing power will not often directly tax themselves, and as the taxing power in this country rests ultimately in the people a tendency to tax a minority, provided of course that the minority has something to tax, is to be expected. The Federal income tax as first applied had a basic exemption of $2000 and other specific exemptions, which resulted in a total exemption to such an amount that the number of taxpayers was by no means enormous. The rates in the upper brackets were high, and a determined effort was made to escape them. The difficulty of reaching all those whose incomes fell within the two lower brackets was very great, and many liable to the tax escaped. The basic exemption has now been raised so that the number of taxpayers has been still further very substantially reduced, and the advantage of a general civic awakening expected to result from the widespread application of a direct tax has not, so far as I am able to perceive, materialized. The high rates in the upper brackets certainly confirmed the opinions of those who were obliged to pay them as to the high cost of government, but I venture to say that they needed no such demonstration to convince them in this regard.

Much taxable wealth is concentrated in more or less restricted areas, and at times there is an apparent concentration when in reality the distribution is wide, as in the case of the main office of a great corporation located in a certain state and its stock held throughout the country. This class of taxable wealth is especially liable to heavy taxation, it is also exposed to the attacks of those of socialistic tendencies, and we find the net incomes of corporations taxed at a high rate. Great aggregations of taxable wealth and large incomes should of course pay their share, and their share is very large, but there is a marked tendency to overdo taxation in this regard. It is one of the most difficult undertakings to convince legislators that increasing the rates of taxation does not necessarily mean a corresponding increase in returns, and that a reduction in rates not only may be advantageous in reducing the pressure on taxable wealth and income but also may, and often does, increase the revenue.

DANGERS OF MATHEMATICAL AVERAGES

It may not be amiss at this point to call your attention to the danger

in employing mathematical averages in formulating tax laws and determining the rates of taxation to be applied.

The Federal Government imposes a tax upon the net income of all corporations within its jurisdiction, and, as one would naturally expect, the rate is comparatively high. This tax must be based on a generalization on a very wide scale, the generalization must be based on averages, and the theory of averages applies with more and more accuracy as the number of units upon which the average is based increases. It is also a fact not usually given consideration that the maximum and minimum variation tends to increase as the number of units employed increases. There are a number of such generalizations necessary in determining corporate net income, the allowances for depreciation and replacements, for example, so that while theoretically net income means the same thing for all corporations throughout the country, practically it is not the same thing at all; also the variation from the average is, for the maximum and minimum, great enough to impose a comparatively heavy burden on some and a correspondingly light burden on others. This difficulty is inherent in most if not all direct taxes imposed upon a heterogeneous base covering a wide geographical extent. The only remedy that I am aware of is a multiplicity of exceptions to the general rule which would make administration very difficult if not impractical. Such a tax does not appeal to one as being exactly ideal.

SHIFTING THE BURDEN OF TAXATION

There is a marked tendency observable to transfer the cost of certain governmental activities from one jurisdiction to the one next higher up, from county to state, from state to the Federal Government, on the apparent assumption that the burden of taxation has in some manner been reduced or eliminated entirely in the process. In some instances the burden of taxation, while not reduced or eliminated, as that is obviously impossible, is very positively shifted onto somebody else. This shifting of the tax burden may or may not be, in a broad sense, advantageous. It is conceivable that under certain conditions it may be either very good or very bad. It is well to bear in mind, however, that those who do the shifting are not apt to take an altruistic view of the situation and very likely will be more interested in the immediate advantage to themselves than concerned with the general result. When this shifting is from the state to the Federal Government the Federal Government becomes in a sense a source of state revenue, and judging by the numerous schemes proposed it is apparent that the Federal Government is deemed to be not only a source of revenue but an inexhaustible one as well.

This tends towards centralization, a tendency which needs no encouragement, as it is well known that governmental agencies are inclined to draw unto themselves more and more authority and powers if they can. Centralization is further encouraged by the very simple device of Federal aid on what is commonly termed the fifty-fifty basis. If certain conditions are complied with the Federal Government will, within limits, furnish an amount of funds equal to that appropriated by the state. This may be an entirely proper and sound financial and governmental policy. It is equally true that it may not be. It depends upon the circumstances, two in particular—the source from which the funds are derived and the nature of the project aided.

Some states need aid, some want it and others neither need nor want it. The latter object to furnishing revenue to be expended on Federal aid projects on the so-called fifty-fifty basis, and also object to the Federal Government, through or under cover of the aid rendered, controlling to this extent the expenditure of state funds.

It would be a decidedly discouraging circumstance if there were any desire on the part of the states to withhold Federal aid from any state which really required it. Certainly I know of nothing that would warrant any such conclusion, and I doubt very seriously that any substantial objection would be raised to aid any project if the aid were necessary, or that any state would be captious about the general benefit conferred.

STATE OBJECTIONS

There are a number of states, however, which object to the present method of rendering Federal aid. Some of the reasons advanced are as follows: (1) That the method is extravagant in itself and encourages states to extravagance; (2) that it requires the expenditure of certain state funds under Federal control and to this extent allows Federal jurisdiction over matters of purely local concern; (3) that it encourages the Federal Government to encroach on the constitutional rights of the states, and that under the guise of conferring a benefit the citizens are beguiled into complacency; (4) that due regard is not paid to the nature of the objects aided and that there is a growing tendency to disregard the criterion of general benefit or necessity; (5) and that expenditures of the public funds are made for local enterprises to encourage Federal control. These reasons may not be entirely valid, but there is certainly a very decided feeling in some widely separated sections of the country that there is a real economic danger to be feared as well as an encroachment upon state governmental functions contrary to the spirit if not the letter of our Constitution, if this policy is expanded, or even continued.

IN SUMMARY

I have been able to treat only very briefly a few of the elements involved in the broad subject, "Federal and State Sources of Revenue." I have attempted to show: (1) That there is danger in the use by the Federal Government and the states of the same bases for taxation, because the sum of the rates is very likely to be higher than either jurisdiction would approve, and these combined rates may be sufficiently high to bring about economic and sociological results not intended nor desired by either; (2) that if the same bases are used by both jurisdictions there will be a tendency on the part of the Federal Government either to drive the states out of the field altogether or to control directly, or more probably indirectly as in the case of the estate tax, the states in the conduct of their internal affairs relative to taxation; (3) that bases of taxation requiring appraisals which necessitate very accurate or extensive local knowledge should be avoided by the Federal Government and left to the states; (4) that there is some danger in attempting very broad generalizations based on average conditions because of the wide variations from the average; (5) that the Federal Government should not be used as a source of revenue by the states; (6) and that it is at least somewhat difficult to tax the general public into an understanding of governmental fiscal affairs, or into a proper conception of their civic responsibility.

The Child Labor Question and the Federal Government

By Owen R. Lovejoy

Chairman, Executive Committee, National Child Labor Committee

IT is my understanding that this discussion of the relation of the Federal Government to the problem of child labor is not for the purpose of projecting any specific propaganda at this time, but rather for the purpose of setting forth as a matter of record the issues involved. With this thought in view, let us see just where we stand today.

What are the arguments in favor of Federal action?

What forces have combined to bring us to the present position?

What logically should be the next step in handling the problem of child labor?

I. Arguments For

The advocates of the proposed amendment to the Constitution hold that child labor is a national problem; that a sovereign government should have the power to protect its own children; that our government does not at present possess any such power; that the amendment as passed by Congress and submitted to the state legislators is properly drawn for the purpose of conferring upon the government such power; and that from the standpoint of every consideration of national well-being, from the standpoint of the protection of our country from dangers abroad and from disruption or disintegration at home, from the standpoint of the development of education, health, and other agencies of social service, from the standpoint of the development of our national resources, and from the entire range of our economic and industrial interests, it seems obvious that a government theoretically based on the integrity and intelligence of its citizenship should have power to protect that citizenship in the development of those qualities.

This is the position taken by the advocates of this constitutional amendment. This is what the amendment has meant and still means to them, and, while as a matter of expediency the National Child Labor Committee is not pressing for ratification of the amendment at the present time, we have never wavered in our belief that it is both the right and duty of the United States Government to co-operate with the governments of the various states in providing the maximum protection for the children within our borders. We have never doubted that the fear of those who contend that the principle of this amendment would abrogate the Constitutional Bill of Rights, would destroy the autonomy of our state governments, would imply the control of our educational system, or would give to Congress a power more extensive than that now possessed by every state, is utterly unfounded.

II. Why Disapprobation?

It is the general opinion that the child labor constitutional amendment is dead. While this is technically not the case and we understand any state which has not ratified is still competent to do so, let us waive the point for the purposes of this discussion. Why is the amendment in its present position? I believe it conservative to state that ninety per cent of the legislators in the various states who voted against rati-

fication did so under an entire misapprehension as to the meaning and purpose of the amendment. Possibly these legislators fairly reflected the opinions of their constituents, though a close following of the active campaign lodges grave doubts.

Immediately upon the passage of this amendment by Congress, skillful opposition was organized and a campaign was conducted under shrewd legal leadership and backed by abundant resources, which reached to practically every section of the country. Under the influence of this campaign, the public was given to understand that ratification of the amendment meant any or all of the following things: The nationalization of American children; the dissolution of the forty-eight commonwealths; the breakdown of family discipline and the disorganization of the American home; the forbidding of every farmer's boy under eighteen years to do any chores around the farm, or the farmer's girl to do simple housework; the prevention of any wage-earning to prepare for college; the employment of hundreds of thousands of Federal bureaucrats spending hundreds of millions of the peoples' money to place a government agent in every American home; and—last but not least—the dawn of Socialism, Anarchy, Bolshevism—the linking of the American people to the Soviet Government in Russia.

If the majority of the American people believed that the amendment meant all or any of these things, they were justified in repudiating it with promptness and emphasis. The minority who know anything about it may have been fairly divided, many believing that the Federal Government should co-operate with the states in efforts to protect American children from industrial hazards; others believing that the states on their own initiative should cure these evils by the development of local state machinery and state laws. But this minority of intelligent defenders and intelligent opponents had scarcely any influence in advancing or retarding this tidal wave.

It may be supposed that the promoters and defenders of this amendment have become disheartened by the popular verdict. Not at all! Those of us who have experienced any disheartening have done so on entirely different grounds. Two years ago the public press was full of the discussion of child labor. Everybody who read was compelled to know something about the issue. Whether the information conveyed in the press was accurate or not, the subject was on the front page. The most outspoken opponents of the amendment assured the public on every possible occasion that, while they were opposed to conferring upon the Federal Government the power against which they protested, they were in favor of the eradication of the evils of child labor and wanted to secure for every American child a fair opportunity for health, growth and education.

A SILENT PUBLIC

Today the public press is silent. Public attention is turned in other directions. Debating societies, pulpits and lecture platforms are turning to other topics. The avowed devotion of opponents to this measure has thus far borne no fruit. Perhaps this was not to be expected two years ago, as those familiar with legislative procedure are aware that after time had been consumed in discussing the Federal proposition legislatures were impatient of spending any more time on any phase of the subject, and, therefore, adjourned without any action relating to local conditions. But nearly two years have elapsed. We are now on the eve

of another big legislative year. So far as our observation goes, no voice has been raised among the avowed advocates of states' rights and the cure of all evils by state procedure, either to protect all children up to fourteen years of age in their right to schooling, or to regulate the hours and conditions of labor of all children under sixteen, or to exclude youth under eighteen from extra hazardous and dangerous occupations.

We are happy to say that the National Association of Manufacturers, through a committee headed by Mr. Howard Cheney, is making a detailed statistical analysis of the extent and distribution of child employment as revealed by the census of 1920. This is a laudable undertaking and we have assured the Association of our most cordial co-operation in this phase of their enterprise. It should be noted, however, that the census of 1920 is already six years out of date, was in many respects inadequate and misleading when it was issued and was so announced by census officials themselves, and that the public is in definite need of statistical information that shall be both accurate and up-to-date.

A Serious Inaccuracy

Meantime, the disheartening phase to which we referred was most blithely expressed in a recent speech by the senior senatorial candidate in New York State, who explained his opposition to the Federal amendment on the ground that all but three states already have child labor laws. Of course in this the Senator was inaccurate. He should have said that every state in the Union has a child labor law. Which would be equivalent to saying that every state in the Union has weather. The effect of this glib sentence is to lull the public to happy and contented slumber. If every state but three has a child labor law, certainly it is assumed that all the children in the country, except those unfortunate enough to live in the three states, are adequately protected; and quite as certainly the citizens of those three states will awaken in the near future and heal the sore so pointedly emphasized by the learned Senator.

This is the sad fact which confronts the enemies of child labor today:—the fact that the public regards the problem as solved, to be filed away like chattel slavery and cannibalism in the ancient archives.

Varying State Standards

In the face of this situation we are impelled to state briefly some of the facts as they exist today. First, as to standards. Second, as to numbers. Third, as to probable trend. To say that every state has a child labor law is one thing. To say that every state has a good child labor law, well administered, is another.

Seven of our states do not require children to attend school after they reach the age of fourteen years. There are nine states in which it is lawful to employ children at fourteen without evidence of ability to read. There are eighteen states that make no provision for determining whether a child is physically fit to be worked before he secures an employment certificate. There are twelve states in which children under sixteen years may legally be worked from nine to eleven hours a day. There are thirty-five states in which children at fourteen may lawfully be worked on scaffolding and around building construction. There are twenty-eight states where children of fourteen are permitted to work in places where explosives are handled or manufactured. There are twenty-two states in which children of fourteen may legally run elevators. Thirty-

three of our states permit children of fourteen to be employed on railroads and seventeen states permit children of fourteen to oil, wipe and clean machinery in motion. These are but a few samples to indicate the present status.

Weighed in the balance of human life, human safety, and American citizenship, every one of these specifications against existing state standards is enough to justify arousing the people of the entire country to a militant protest against the cavalier dismissal of the whole subject by the brief statement that all but three states have child labor laws.

NUMBER OF CHILDREN EMPLOYED

Second—as to numbers. We have already stated that on its own authority the census of 1920 acknowledges that the figures are incomplete. They report only the children found at the specific time when the census was taken. They do not purport to report all children. Therefore, the figures I am about to give represent the minimum and not the total.

According to the census report, there are over 76,000 children between ten and thirteen years of age at work. This does not include the special objects of the avowed solicitude of the National Association of Manufacturers, namely, children on home farms. There are more than 144,000 in the twenty-five states that fall below the standard of an eight-hour day, or permit night work for children under sixteen, and this also excludes all clerks in stores and all children working on home farms. In addition to those included in the above number, there are over 12,000 in the seventeen states which permit children of fourteen to oil, wipe and clean machinery in motion, and over 238,000 more in the thirty-six states which do not protect children of sixteen from this dangerous occupation.

The total number of children involved in this failure of the states to protect their own is 553,106. Over half a million of our American children and youth constitute the human side of a problem which is popularly believed now to have been solved.

INCREASING DEMAND FOR CHILD LABOR

Third—as to trend.

A third fact which must be kept in view is the probable increasing demand for the employment of children. Three forces work in this direction.

First, restricted immigration. We believe the temper of the American people is in the direction of still further restriction. This will tend to eliminate from our labor market multitudes of foreigners coming from low-wage countries and countries of low standards of living. Yet our American industries are geared to use this kind of labor. If the illiterate foreigner cannot be mobilized into the industrial army and if the high school educated American refuses to come under the yoke, where shall our industries turn for their labor supply?

The second force is the progressive simplification of industrial machinery. Mechanical processes, once complicated, are now by inventive genius being broken into simpler parts, and processes that formerly required the skill and supervision of a trained worker may now be performed by small hands which can be trained to the job within a few days or a few weeks.

The third force comes from the field of education and we have already become familiar with the cry that so large a percentage of our population is dull, stupid, backward, or feebleminded that to expend money on their public education is a waste both of public funds and the individual's time. If

they cannot learn beyond the fourth grade, the fifth grade, or the sixth grade, why not turn them out of school and let them go to work? And this in face of the fact that three to five times as many children leave poor ungraded schools as leave well organized graded schools to go to work. Until we have made an honest attempt to build up our educational system to fit the needs of our children, it is rank hypocrisy to say that they cannot learn. One state reports that while one child in every thirty-five left the ungraded schools to enter illegal employment, only one in 600 left the well graded schools for this purpose.

This is a cheap and easy way of solving a knotty educational problem and by the same process of salving the public conscience.

But it does not solve the problem, as every student of industrial history is aware. To turn an army of young children into industry, to fight barehanded in a competitive battle which becomes fiercer every year, is not only inhuman in the extreme, but destined to destroy the very interests responsible for it. Low paid, low grade labor, the operations of unskilled hands, the fatigue of long hours at exhaustive work, the denial of education to those who do not instantly respond to the fixed mechanism of its present day development—all those are but varying phases of a slow industrial suicide, still more tragic, of social suicide, as the future will most certainly attest.

STEPS TOWARD ERADICATION

Recognizing that this evil exists in the varying forms, and at least to the extent hereinbefore stated, what are the next steps?

As for the National Child Labor Committee, which I have the honor to represent, we continued taking the next steps through the entire amendment campaign, because for over twenty years it has been the fundamental purpose of this Committee to co-operate with the citizens of every state in drafting their own laws and administration. When it became evident that the people of the country would not tolerate any co-operation from the Federal Government, we readily responded that our interest was in the cure of the patient rather than in the kind of medicine to be prescribed. We, therefore, welcomed with eagerness the pledges of individuals and organizations to work immediately for the eradication of such evils as existed within the bounds of their own commonwealth and especially the proffered co-operation of manufacturers' associations to the same end. We have followed this policy, especially for the past eighteen months, with constant and active devotion and find, despite the general apathy which we have discussed, an encouraging number of enlightened citizens in every state ready and willing to assist in bringing their state up to standard.

But, as I indicated in the beginning, the voice of business is significantly silent at the moment and we welcome the opportunity to hear from the recognized spokesman of the most powerful association of manufacturers in America a statement of their position. Because we know that if the Association of Manufacturers so determines, they can wipe industrial child labor from our map in less than two years, we stand, as we have said, for the following minimum standards:

(1) The elimination of all child labor under fourteen years of age.
(2) The limitation of hours for all children under sixteen to eight hours a day, six days a week, and no night work.
(3) The prohibition of children under sixteen from dangerous occupations.

(4) The prohibition of children under eighteen from extra hazardous and dangerous occupations. All these occupations to be carefully analyzed and designated by properly constituted authorities in the various states.

(5) The prohibition of labor of children under sixteen, unless they have had the privilege of at least eight grades of elementary school or the equivalent thereof.

We definitely ask whether or not any of the above specifications are extreme, radical, or unreasonable. If they are conservative and reasonable, we ask active and immediate co-operation in securing their realization in every state of our American commonwealth.

But if the states—if even one of the states—persists in refusing or neglecting to provide adequate protection to the children within its borders, we hold that these children are also children of the United States and that the duty and the right devolve upon our whole people, expressing themselves through our sovereign government, to remove the constitutional limitation by which we are now debarred from affording this protection. For we hold that every child is no more a citizen of the *state* in which he lives than of the *United States* in which he lives, and that the citizens in all parts of our country have a definite stake in the well-being of all children, wholly regardless of the adventitious existence of state boundaries.

Is Child Labor a Government or State Question?

By James A. Emery
Counsel, National Manufacturers' Association

I GATHER that my distinguished friend, Mr. Lovejoy, "the friendly enemy," who has discussed the concrete proposals which he now somewhat vaguely describes as an academic issue on other platforms, is not entirely satisfied with the verdict of the popular jury to which such proposals were submitted.[1] The issue before us is a very large question. It is not only a great social problem, it involves fundamental principles of government. It has been well said here that "the sovereignty should have the power to protect its citizens." We live under a dual form of government. The issue presented here is not whether the sovereign in Federal authority should possess that power, but whether it had better remain where it now is: in the sovereign authority of the respective states, the units through which we preserve self-government and undertake to meet the problems peculiar to locality.

The so-called 20th Amendment—and I hardly venture to describe it by number, because others are liable to seize upon that number if various proposals under discussion are to reach the point of congressional submission to the people—is not an "academic" issue. It is a concrete question. For under our written Constitution we have provided for the submission of an amendment to the organic law, but we have written into the national Constitution no limitation as to the time within which that amendment shall be acted upon. The amendment in question, unlike the Prohibition Amendment, contains no limitation as to the time within which it is to be considered. Those who proposed it rejected every amendment intended to limit the time within which the verdict should be rendered by the jury. Under the discussions of the Supreme Court of the United States, an amendment submitted and otherwise unlimited, remains before the legislators as long as it may be termed a "contemporary" issue. For obviously time may lapse that would make an amendment proposed utterly without contemporaneity.

There have been over 3000 amendments proposed to the Federal Congress during our history and but five of these have been submitted to the states. None of this could be said to be the subject of conclusive rejection, in that by vote of the legislative bodies they had been disposed of beyond reconsideration. Generally they lapsed into the limbo of desuetude. It is interesting and certainly significant that never before in the history of submitted amendments has the answer by the states on the roll-call for ratification been so prompt and so overwhelming. I am not here to measure the value of that verdict. I call your attention to the fact. Now perhaps the reason for the verdict is to be found in the character of the proposal. It is intimated that the facts obtainable from the most authoritative source of information to which we could turn for information upon the character and extent of child labor employment—the Federal Census—are neither complete nor satisfactory. Such infor-

[1] *See* page 28.

mation may lack detail, but I think we will perceive upon examination that it is adequate to meet the essentials of the issue; that is, is child labor on the increase or the decline? Is it a serious fact in industry or not? Have the states been so negligent in dealing with the problem as to warrant an unprecedented grant of power to the Congress as the only remedy for the situation? Let us then examine the facts and principles involved, since this is not an academic question but a very concrete one. What is the answer of the popular jury to which the issues were submitted? Why was it so answered? That may throw a flood of light on the subject before us—"Child Labor and Congress."

REACTION OF THE STATES

As the matter stands now, within a year thirty-six states have refused ratification; five have taken no action; two have had no session of the legislature; four have ratified and one of these (Arkansas) has sought to reconsider the action. New Mexico approved the amendment in its assembly but apparently declined further action in the senate. Massachusetts preceded its legislative disapproval by condemnation through a popular advisory referendum of its citizens. I refer to the action of Massachusetts because that state became a great popular forum. Certainly no constitutional question since the Civil War, and probably I ought not to subject my remark to that limitation, was more thoroughly discussed throughout the state than the so-called "Child Labor Amendment."

To say that the popular action was based on misapprehension or misrepresentation of the proposal is to ignore the ample opportunity possessed and employed for the correction of any misstatement or any error of the critics of the amendment. Certainly the action of Massachusetts was not hasty, nor is it a commonwealth given to impetuous and hasty action. Neither the history nor habits of Massachusetts rank it among the immature or rash states of the Union. If, as has been suggested in criticism of the verdict of the Bay State, its electorate acted in "a panic of thought," it is to be observed the panic was aided by such reckless thinkers as the distinguished president of Harvard University, the Catholic Archbishop and Cardinal of Boston, the Episcopal Bishop of Massachusetts, a great body of educators and social workers and an overwhelming majority of the bar and the bench.

If, therefore, the jury was neither in a frame of mind nor by nature qualified to pass upon the problem, where else in the United States are you likely to secure a jury better qualified?

The representative judgment expressed by the legislatures of the country cannot be said to reflect sectional group or class opinion. On the contrary, more states have condemned the proposal in the North than in the South. It was equally unpopular in the West and the East. The disapproval of the industrial states was as pronounced as that of the agricultural communities.

ISSUES INVOLVED

With the topic before us we may properly ask ourselves now, what were the issues which in so brief a period transformed an apparent social sympathy with a cause to antipathy for a proposal? The amendment is simple in its language. It declares that "Congress shall have the power to limit, regulate and prohibit the labor of persons under eighteen years of age." The power of the states is to remain unimpaired save that "the operation

of state laws shall be suspended to the extent necessary to give effect to legislation enacted by the Congress."

Now there never has been, never will be, in my opinion, the slightest disagreement among an overwhelming majority of American people as to the necessity of protecting children from injurious employment, and the securing to them of adequate educational opportunity. The popular disapproval of the amendment arose from no lack of sympathy with its avowed purpose. I believe it represented a deliberate rejection of what came to be clearly understood as a revolutionary innovation in Federal authority, supported by assertions with respect to the nature and extent of child employment and exploitation which were found to have slight justification in fact.

We see some evidence of the latter condition in the expressions of one of the most notable and ablest of the proponents of the amendment. When the members of the Senate Committee on the Judiciary were hearing the argument for the proposal, the Senator from Montana, than whom there has been no more determined proponent of the proposal, sharply objected when the Chief of the Children's Bureau listed his state in the second class of commonwealths, as one of those which were lacking in adequate child labor legislation, and denied that there was any occasion to legislate against child employment in the mines of Montana, since there was no record of the employment of children there. We had other instances, of course, where the legislation of particular states like that, notably of Massachusetts, was described as utterly inadequate because it contained no provision within its child labor legislation to prohibit the employment of children within mines, and yet so far as I have been informed by the latest researches on that subject, no mines have been found in Massachusetts.

Now this proposed amendment sought to confer upon the Congress an exclusive and plenary right to control not merely the working life of children, but of every person within the United States under eighteen years of age. It proposed to confer the power to prohibit all such persons from earning a livelihood in any or all forms of employment, or even to engage in any occupation in aid or support of or at the request or direction of their parents or guardians, at any time, or place, and not less at home or within their premises than on their farms or within any establishment.

The power "to prohibit" includes not only the right to exclude from every form of employment, but that larger right to determine the conditions under which any person under eighteen years of age may be permitted to engage in any occupation. It, therefore, necessarily includes not only the power to say what hours such person may work and at what employment, but the wages to be paid and the standards of educational training which must be met before any person under eighteen will be permitted to work at all. That is not Federal control of the school, if you please, but a grant of congressional power to determine those preliminary qualifications or standards without which no person subject to congressional control could earn his own living or contribute to that of those dependent upon him.

Nor is it work alone that is thus subjected to Federal rule. The authority of the regulatory body extends by necessary implication to the control of leisure to such extent as would be necessary to prevent the defeat by subterfuge of any policy which Congress might adopt, for the growth of political authority carries the right to

make it effective. It would obviously convey the right of taxation for the support of any under eighteen prohibited from labor, or parents, guardians or other persons dependent upon the aid of such prohibited, which would carry the right to create such boards or commissions, appoint such officials and levy such taxes as in the judgment of Congress were necessary to make its authority effective. Nor is it possible to conceive a Congress exercising the police authority over the subject matter committed to it except through bureaus or commissions or boards or through officials appointed for that purpose and exercising the same powers that we are familiar with in the various boards or commissions through which Congress today enforces regulation throughout the states in matters of health or quarantine. The proposed amendment, therefore, conveys a power in terms and to an extent not now possessed with respect to the same subject matter by any state of the Union.

One of the most common statements made with regard to it was that it was merely conferring upon the Congress a power which the states at present possess. It confers far more than that, for the characteristic local control which the people of a state exercise over their own legislature would obviously disappear. A distant and irresponsible majority unfamiliar with local tradition and circumstances would write the household rule for family life they did not share. Each state would exchange the full authority which they now possess for a two-ninety-six control in the Senate and a small faction among the four hundred and thirty-five members in the House in proportion to the number of representatives possessed by each state.

The loss of protective legal restriction is no less clear. For what is proposed is a plenary grant to the Congress of a police power over the occupational life of all under eighteen free from the constitutional restrictions which surround its present exercise by the states. The power to prohibit women or minors from engaging in particular occupations has long been a recognized part of the police power of the state, but no lawyer of respectability will say that the states may arbitrarily exclude every person under eighteen from all forms of employment. For example, prohibit under penalty such persons from engaging in any agricultural or clerical pursuits. It is no answer to indignantly assert that Congress would never exercise such power, for in the light of experience with what Congress has done when it possessed the power to do it, it expresses a superabundance of confidence in voluntary political restraint. We cannot prophesy how such power will be employed, but a prudent community with a century and a half of experience with the constant necessity for applying the restraints of a written constitution to public action is reluctant to grant to a central government, which could administer its authority only through bureaus and bureaucrats, such unprecented control of intimate, private relations.

NO NEED FOR GOVERNMENT INTERFERENCE

Finally, the facts present no overwhelming necessity which is the ultimate justification for innovation in constitutional government. On the contrary, they demonstrate that local government has neither neglected its child labor problem nor failed in the development of sympathetic public opinion. On the contrary, the 1920 Federal census pictures 1,500,000 more American children between ten and

fifteen years of age than ten years before, with 900,000 *less* children *at work* in any occupation than in 1910 and reaches the conclusion, there stated in its own language, that in recent years children have not been an important factor in the total labor situation in non-agricultural pursuits. The only place in the country showing an increase in child labor is the District of Columbia, under the exclusive control of Congress, to whose guardianship it is proposed to wholly submit the children of the entire United States. The child labor laws of the District of Columbia drafted by the Congress exempt from their operation the children employed by the Senate as pages. Without restriction as to night work, more children under fifteen are employed by Congress than many industrial communities with a population of one hundred thousand.

Under state regulation, the number of employed children radically decreased between 1910 and 1920. It declined from 18.4 per cent of children from ten to fifteen years of age in 1910 to 8.5 per cent in 1920. This decrease is not effected wholly by state legislation, however. By any means it is a rising standard of living that is probably the most important factor. The proportion of children engaged in agricultural pursuits declined from 13.2 per cent in 1910 to 5.2 per cent in 1920, while the children in non-agricultural pursuits declined from 7.5 per cent from all ten to fifteen years to 3.3 per cent in 1920. The rate of progress in Mississippi showed a decline of children's employment from 53 per cent to 29.5 per cent in 1920, while in Massachusetts the decline is from 9.6 per cent in 1910 to 8.6 per cent in 1920.

The South with all its terrific problems to face in connection with its children within the limits of its resources appears to have faced them in most instances with generosity and courage under state control.

The record of what has been accomplished in the states in the regulation of children's employment leads us to the consideration of the more difficult problem of this country. Eighty-nine per cent of ten- to fifteen-year-old children were registered for school in 1920. There were 8.5 per cent said to be at work and 2.5 per cent were unspecified. I pause there for the moment, because it is an easy matter in a discussion of this kind to misinterpret a phrase; thus the term, "gainfully employed," which is the census term upon which all our statistics are predicated would naturally cause you to believe that it represented children "employed for pay" or who were steadily at work, but that is not the fact. It is a census term which includes all who work even for their parents or guardians or after school hours or during vacations. It is only necessary for a youngster to have regular work for half an hour a day to be "gainfully occupied" within the meaning of the census. It is with that meaning attached to the term that you must interpret the information provided by Federal statistics.

But to return to the school condition. The proportion of fourteen- and fifteen-year-old children attending school throughout the period of 1910 to 1920 has increased more than 5 per cent and these are obviously the ages most affected. The trend of this growth was uniform in all the states, only the District of Columbia and five states showing any decline in 1920 over 1910, but the Southern group of states made the most distinct progress. From later figures in the Department of Education, it seems likely the increased school attendance in the last five years may have equaled that of the preceding

ten. I have no figures available, but the tendency of the curves of statistics suggest that over 92 per cent of the children ten to fifteen years old may now be in school; figures in regard to high school children show a very rapid rate of increase in numbers there, averaging 1 per cent per year for the past four years, and a total of 8 per cent for the last nine years. Here again a glance at the figures will show a striking contrast in figures. California provides high school opportunities for 30 per cent of the total enrollment in public schools; North Carolina 5 per cent; and Connecticut, a median state, a little more than 13 per cent.

If the object then of Federal control is the removal from manufacture, it is easy to be seen that great progress has been made all over the country. Even in textiles, which employs more children than any other mechanical industry, employment has declined from 10 per cent in 1910 to 5.8 per cent in 1920—a considerable percentage below the ratio in agricultural pursuits. Since about 1920 the mechanical and manufacturing industries have employed less than one half of one per cent of the total children between the ages of ten and fifteen years. It is practically true that they have ceased to be a factor in the labor problem. Industry as a whole has found that it does not want the labor of fourteen-year-old children when less than one half of one per cent of the children in 1920 were found within its ranks by the census. This lesson has been learned under state control of the problem. To a considerable extent, it was accomplished without legislation and under the influence of natural economic and social influences. A further lesson to be learned is the extent to which social and racial questions within the states have affected its progress, as well as the wide variation of economic and occupational conditions.

I want to assure all of you who are interested in this important subject that manufacturers as fathers and as citizens are just as keenly interested in the children of the United States as any other class in the community, whether they look at the problem through the spectacles of their own paternal relation or view it with the sympathetic aspect of a citizen looking at the future of his own country. What the relation of the educational system is to this problem—and that is the most difficult and delicate of all relations—I am not qualified from special study to say. But this must be sure, as Mr. Lovejoy has said, it is for the states to improve their educational system, for that is a great local problem.

The citizen of Massachusetts is not the best judge of how Georgia shall train her children, nor is Georgia the best authority upon the system of public education best suited to Massachusetts. It has been a tradition that the children must, in the first place, through the family, develop the underlying personal qualities upon which the future of our race and country rests. Character is a product of the fireside. Each community is the best judge through co-operation with the parent as to what educational system is best. That cannot be done through a Federal control of education, which has been rejected again and again as a national proposal. It can be done with the co-operation of the Federal Government, and within its own domain the Federal Government has a large control over this problem today.

The public opinion that has refused to grant congressional control of the employment of American youth is resting its judgment on the fact that there is no justification for the demand, and

that the national legislature is not fitted for the task of meeting a local problem in terms of local conditions, nor should it be permitted to lessen the local responsibility of the citizen for the greatest of his social duties.

IN CONCLUSION

Let me in conclusion say, lest I be easily misunderstood, that I am not arguing over again the issue so constantly described in the political literature of the past as that of "state rights." "State rights," in the sense that term was originally used, perished in the Civil War. In the sense in which we employ it today, the great commonwealths constituting the American union are the fundamental units of self-government and there can be no good national government unless there is good local government. It is in that sense, if I use the phrase at all, I would talk about "state rights"; rather, would I talk about the thing in which I believe we all join, and that is state "duties."

The duty of local government to protect its citizens in all activities is the first of its great police obligations. Upon it devolves through its educational system the primary duty, next to that of the parent, of providing for the development of the intelligence of its citizens. That is primarily a great question of local responsibility. Now we have been developing the larger phase of this great question. We have unhappily much evidence of a tendency on the part of local government or local citizens to fly to Washington very much like a frightened child to its mother. For the ancient phrase with which we are familiar in the private affairs in life, "let George do it," by which we mean, let the interested public citizen do all the work, and let us enjoy the benefits of it, we have been substituting in many communities the cry "Let Washington do it." Yet, when Washington has undertaken to meet many of the problems, surely those who have watched its operations cannot be impressed with the fact that it discharges police duties more successfully than the states.

Local government is not only the primary school of all good popular government, but local responsibility for the cure of local conditions is the great obligation that must be thrust upon the citizen, if he is to learn in the hard school of experience the great fact that reform at home and within his own community,—the betterment of immediate conditions—is the greatest contribution that any people can make to better government in the nation.

State Versus Federal Regulation of the Labor of Children

By Howell Cheney
Cheney Brothers, South Manchester, Conn.

UNDER state regulation the number of employed children radically decreased between the years 1910 and 1920. It declined from 18.4 per cent of children ten to fifteen years of age in 1910 to 8½ per cent in 1920 (Chart I). This decrease was influenced by state legislation but was by no means entirely due to it. A rising standard of living was a most important factor. The proportion of the ten-to fifteen-year old children in agricultural pursuits, which were affected but little by legislation, declined from 13.2 per cent in 1910 to 5.2 per cent in 1920; while the children in non-agricultural pursuits, against whom legislation was mainly directed, declined from 7.1 per cent of all ten-to fifteen-year old children in 1910 to 3.3 per cent in 1920 (Chart I).

Though the positive points attained were not as low in the South, where there was little legislation, the rate of progress was far more rapid than in the North. For instance, in Mississippi the proportion of ten-to fifteen-year old children employed declined from 53.4 per cent in 1910 to 25.5 per cent in 1920 (Chart II); while in Massachusetts, which represents the median state, the decline was from 9.6 per cent in 1910 to 8.6 per cent in 1920. The District of Columbia under Federal control was the only jurisdiction in the country in which the ratio of employed children was greater in 1920 than in 1910, by even a small amount. The South has had terrific problems to face in connection with its children, but within the limit of its resources appears to have faced them in many instances both generously and courageously under state control (Chart II).

If the object of Federal regulation is the removal of children from the mechanical and manufacturing industries, it is easily demonstrable both that great progress has been made in all sections of the country, and particularly in such industrial states as Pennsylvania, Ohio, Illinois, Michigan and New York. Even in the textile industry, which employs more children than any other mechanical industry, the ratio of ten-to fifteen-year olds to total operatives had declined from 10 per cent in 1910 to 5.8 per cent in 1920 (Charts I and III), or below the ratio in agriculture. Since by 1920 the mechanical and manufacturing industries employed less than 1½ per cent (Chart III) of the total children ten to fifteen years of age, it is practically true that they had ceased to be a factor in the labor problem of industry. Industry as a whole had found conclusively that it could prosper without the labor of children under fourteen years of age, when less than one-half of one per cent of the children under fourteen years of age were found in 1920 by the census enumerations within its ranks. This lesson had been learned under state control. To a very considerable but immeasurable degree, as has been shown, it was accomplished under the influence of natural economic and social laws.

The further lesson to be learned from a statistical study of this development by states is the extent to which the

social and race questions within the states have affected its progress, as well as the wide variation in economic and occupational conditions.

DIVERSITY OF PROBLEM

The record of what has been accomplished under state control in the eliminating of children from employment leads us to a consideration of a more difficult problem which *has* grown out of this social and economic development.

Eighty-nine per cent of the ten-to fifteen-year old children were registered as in school in the year 1920 (Chart IV), 8½ per cent were at work, and 2½ per cent were unspecified. The proportion of fourteen- and fifteen-year old pupils attending school (Chart V) had increased 5 per cent in 1920 over 1910. These ages were obviously the ages most affected. The trend of this growth was remarkably uniform in all of the states, only the District of Columbia and five states showing any decline in 1920 over 1910. But the Southern group of states made the most distinct progress (Chart V). From later figures from the Department of Education it seems likely that the increased school attendance in the past five years may have nearly equalled that in the preceding ten years. The tendency of the chart curves would suggest that over 92 per cent of the children ten to fifteen years of age may now be in school. Figures in regard to high schools (Chart VI) show the very rapid growth in numbers here, averaging 1 per cent a year for the last four years, and a total of 8 per cent for the last nine years. Here again a glance at the chart shows the striking variation between the different states in their provision for the older children. California provided high school opportunities for 30.2 per cent of the total enrollment of pupils in public school, North Carolina for 5.1 per cent, and Connecticut, the median state, for 13.8 per cent.

The character and size of the increased burdens which have been placed upon the body politic by the elimination of the children from occupations and their addition to the school system illustrates how absolutely interdependent are these two problems. Just as in any one family what was yesterday a problem of education becomes tomorrow a problem of employment, or vice versa; so in a community or a state the question of increased education becomes immediately a question of increased resources in wealth, in teachers, in buildings, and in educational material.

There were in 1924 in our schools 6,475,000 more children than there were in 1910, and at least 2,710,000 more than were in 1920. At the same rate of increase another 1,354,000 have been added in the last two years, making over 4,000,000 since 1920. The influences which have either retained them there or kept them out of employment are by no means simple. The most potent are perhaps the rising standards of living and of social values. Legal regulation has contributed. Under legal regulation the deficient and defective are not eliminated when they reach the working age. At the other end of the scale, there has been an immense extension of high school courses and an immense increase in the high school registration. Finally, all through the eight years of elementary course and four years of high school course, the curriculum has been extended and enriched. Communities have been lavish sometimes to the extreme in their appropriations for new school buildings. There is a slowly increasing public recognition of the necessity of better teachers and better paid teachers. But each one of

these influences (it is sometimes difficult to separate them in their effects) has a definite bearing upon the tax budget and the available resources. It is practically impossible therefore to approach the subject of the regulation of the labor of children without considering its effect upon the alternatives in opportunities which it offers, and their bearing upon the ability of the state to assume the increased burdens.

PER CAPITA COST

The cost of public education per capita of total population has advanced in the United States from $2.84 in 1900 to $4.64 in 1910, $9.80 in 1920 and $16.25 in 1924. Even allowing for the decreased purchasing power of the dollar and using index number 160 as an equalizing factor, the 1924 figures show an increase of three and one-half times over the 1910 standard (Chart VII). Here again there are the widest differences by states. California is now paying $31.75 per capita of population for educational purposes, and Arkansas $5.15. The Southern states as a rule are of course far less able to support this educational advancement than are the Northern, Western and the Eastern states.

There are many surprises in this list. Connecticut, for instance, which we think of as a wealthy state, is only on the median line. Rhode Island, New Hampshire, Maine and Vermont are considerably below the median line; while such agricultural states as California, Nevada, Wyoming, North and South Dakota, head the list; and two states, Idaho and Montana, are spending less in 1924 per capita than they spent in 1920, though Idaho of all the states made the most rapid advance in 1920 over 1910.

The striking differences between the states is even more broadly illustrated when we endeavor to compare the proportion of per capita wealth which is devoted to education in each state relative to what it considered its other necessities. We find, for instance, that in 1924 the positive per capita expenditure for education in Nevada was second in the list with an expenditure of $27.28 per capita of population (Chart VII). Out of every thousand dollars, however, of relative per capita wealth or total resources in 1922 (Chart VIII), Nevada spends but $3.09 for education against a maximum of $7.70 in Oklahoma. North Carolina is the median state, expending for education $4.89 out of every thousand dollars of relative per capita wealth. This table does not by any means show the variation between the two means that the former table of positive per capita expenditures for education did, and indicates that there is much more definite correlation between the cost of education and the relative per capita resources or total wealth of the community than there is between the cost of education and the direct per capita expenditures for education. This, of course, is only a demonstration that the existence of resources does not so definitely determine the amount which a state can spend on its educational system as does the actual distribution of its budget between its total demands (Chart VII). Tested by either method, however, the Southern states have a far more difficult burden to carry than have the Northern and Western states.

Chart VIII illustrates an endeavor to find the correlation between the estimated *wealth* per capita of each state, and the state's *expenditures* per capita of total population for education, and the state's *expenditures* for education per capita of population of school age, five to seventeen years of age inclusive. The latter seems to furnish the highest degree of correlation of any of the three factors; but a glance at this chart, how-

ever, will show in a most graphic way the difficulty of the individual states to adapt themselves to any common measure in the distribution of their resources. The average per capita wealth of the United States is $2,918.00. The average expenditure per capita for education is $14.47, and the average expenditures per capita of population five to seventeen years of age is $55.22. Here again the Northwestern and agricultural states show that they are most easily carrying the burden, and that the Southern states have an infinitely more difficult problem to face and must do so with the realization that the opportunities open to children will differ very materially as between states. It might be argued that the logical cure for this situation is to treat the country as one unit and to distribute its entire resources without regard to present taxing units or legal jurisdictions. This, of course, would simply mean wiping out our state theories, traditions, community controls of education, and ideals of self-government.

STATE ACHIEVEMENTS

As against this we find the history of numerical achievement of the last ten years by no means discouraging, and that the states have in their own ways and within their own resources made tremendous strides. Let us, for instance, take the condition of illiteracy of the juvenile population ten to fifteen years of age (Chart IX). In Louisiana 24½ per cent of the children ten to fifteen years of age were illiterate in 1910; 14.1 per cent in 1920. In all of the Southern states, to which the problem of illiterates among children of school age is largely confined, progress has been equally encouraging. This chart further illustrates how this is a problem of the negro and what is known as the "poor white" population, and that it is confined practically to the Southern states. In only fourteen states of the Union is the percentage of illiterates to total number of children ten to fifteen years of age in excess of 2 per cent in 1920, and in the whole Southern group the average has been cut down from just under 10 per cent in 1910 to 5.7 per cent in 1920 (Chart IX).

The high school attendance in the Southern states, while the rate of increase is not as high as in the North, shows a decided tendency towards improvement, greater perhaps in view of the resources available than in the North (Chart VI). The increases in the proportion of population in school attendance fourteen to fifteen years of age (Chart V) also shows a greater degree of improvement in the Southern than in the Northern states. The length of the school term as fixed by legal enactment and also the days that the schools are in session compare quite favorably in the Southern states with those in the Northern states. Here again, considering the resources that are available, the results are measurably better (Chart VIII).

As a New England man, therefore, I am obliged to confess that I find the Southern states, measured by their resources available, have met their educational responsibilities rather more generously than have the Northern and Eastern states. They have done this under state control.

So far as progress is measured by mere numbers under some form of education, or by dollars spent, or by the ratio of expenditures to population, or by the days and hours under instruction, the evidences of advancement are at hand. They show at least on the numerical basis no lack of state pride or determination in shouldering the rapidly increasing educational responsibilities, which have been committed to

them as guardians of the labor of children, and as instructors of their minds and bodies. No Federal direction or even supervision could have gone as far in trying to adapt local resources to a great onward sweep.

FROM THE SCHOOL ANGLE

When we endeavor to measure the results of these reforms we get an even more pronounced picture of the difficulties involved; of the inseparable relationship between the labor and the education of juniors. In trying to escape from one horn of a dilemma we have impaled large numbers of children upon another horn. If it is true that large numbers of children were protected from the exploitation of industry, it is more than true that many were exposed to the suffocation of education under a system which was either far beyond their abilities, or incapable of adapting itself to the size of the task imposed upon it.

Chart X illustrates the mortality which the public school system suffers in its efforts to carry its load along at a normal rate. To make this clear, the United States Bureau of Education has ascertained the per cent of pupils surviving to each grade out of a total of over 7,800,000 pupils who started in the two classes of 1911 and 1913. Out of the class of 1911 but 8.8 per cent survived to high school graduation, which is perhaps not surprising. The class of 1913 did better with a survival of 11.7 per cent. The surprising thing, however, is that but 63 per cent were promoted at the end of the first year. From there the losses were continuous, but gradually increased until they were more rapidly accelerated in the fifth to seventh grades, or until release from school came. By the end of the fifth grade nearly half of them, or 46.7 per cent, had fallen behind, and by the end of the seventh grade only three-eighths were in the normal line of promotion.

Chart XI gives the same picture from another angle. It illustrates the distribution of pupils by grades by ages—the great loss through a poor start in the first year; the more gradual falling behind until the acceleration is increased by reaching the limits of mental ability towards the fourth and fifth grades. Chart XII helps even more definitely to realize the extent of this loss in wasted years, and to analyze it into the proportion that are retarded for from one to five years. It is quite clear that in the average, approximately 30 per cent of the children leaving from the fifth, sixth and seventh grades have lost one or more years, and out of this 30 per cent approximately 58 per cent have lost or wasted one year, 28 per cent two years, 10 per cent three years, and 4 per cent four or more years, before a release from the accumulating failure in school comes to them. The average loss of time for the whole group of elementary pupils up to the end of the sixth grade was over one and a half years.

For that smaller portion of the group who went to work as soon as the law permits it may reasonably be shown that by and large throughout the country they have wasted at least two years of their lives as far as making mental progress goes. For two years they have been dulled in failure at tasks they were either incapable of performing, or that the school was incapable of presenting to them. In other words, this means that as regards a very large group of pupils state regulation of labor had gone far in advance either of the mental ability of the pupils most concerned, or of the available resources in money, teachers and ideals to meet the situation. Could it by any possibility be argued that if under Federal control the regulations had been advanced, the

suffocation and retardation and wasted years would have been less? The plea for Federal control found justification in the minds of its proponents only in advanced standards. If they admitted that the standards were as high as available resources, both financial and ideal, permitted, they had lost their case before the argument was begun.

IN CONCLUSION

I would refer you to the investigations of two professional educators, both of them women: Dr. Helen T. Wooley of Cincinnati, whose investigations were inspired in part by the National Child Labor Committee, and Dr. Anna Y. Reed, Professor of Personnel Administration of New York University, whose work has been supported through the Junior Personnel Service. These women have devoted themselves to the problem of finding out why educational achievements have not kept pace with the army of nearly eight million pupils who have been added as new pupils to our educational ranks during the last sixteen years. Their conclusions, of which Mrs. Reeds' are not yet published, are practically in agreement as to the following:

(1) That mental ability is the major factor both in retardation in school and in elimination from school.

(2) That economic pressure or poverty was of far less importance, either in removing children from school or in forcing them into employment.

(3) That among the children who were retarded, those who left school to go to work have advanced rather more rapidly mentally and physically than those who had stayed in school.

(4) That industry was not in itself a cause for delinquency, or of either mental or physical degeneration. Moral delinquency they traced much more definitely to home and school environments and to the habits of failure and discontent incident to being forced to continue tasks at school which they were incapable of mastering.

(5) That there was slight, if any, correlation between school grade attained and wages earned; that the "collar and cuff" and clerical jobs did not pay as much as manual work; that the slogan, "Education Pays," was a myth except where increased education was related to ascending grades of mental ability.

Mrs. Woolley still believes that ultimately the schools may be able to meet the task imposed upon them, but both women recognize that education is not a commodity which can be transferred to millions of children under fiat of law without respect to their mental ability and without respect to the resources available for the undertaking. Nothing has done so much to clear away some of the fogs and sentiments which have hung about the child labor and educational problem as have the researches of these two individuals. Both finally come to the conclusion that advanced education cannot be a question of mass education. It must be a question of individual capacities and abilities. Both investigations also clearly show the intimate interdependence of the principles of exclusion from labor and ultimate education. The principle of Federal control purposes to divorce these complimentary opportunities for children. It proposes to give to the Federal control the power to impose by fiat of law the definition of the opportunity to labor. It proposes to leave to the individual state the solution of the problems arising out of this fiat. The undertaking is bound to fail quite as much in the state of California as in that of Mississippi, and the results would be quite as unfortunate to Massachusetts as they would to Alabama.

CHART I

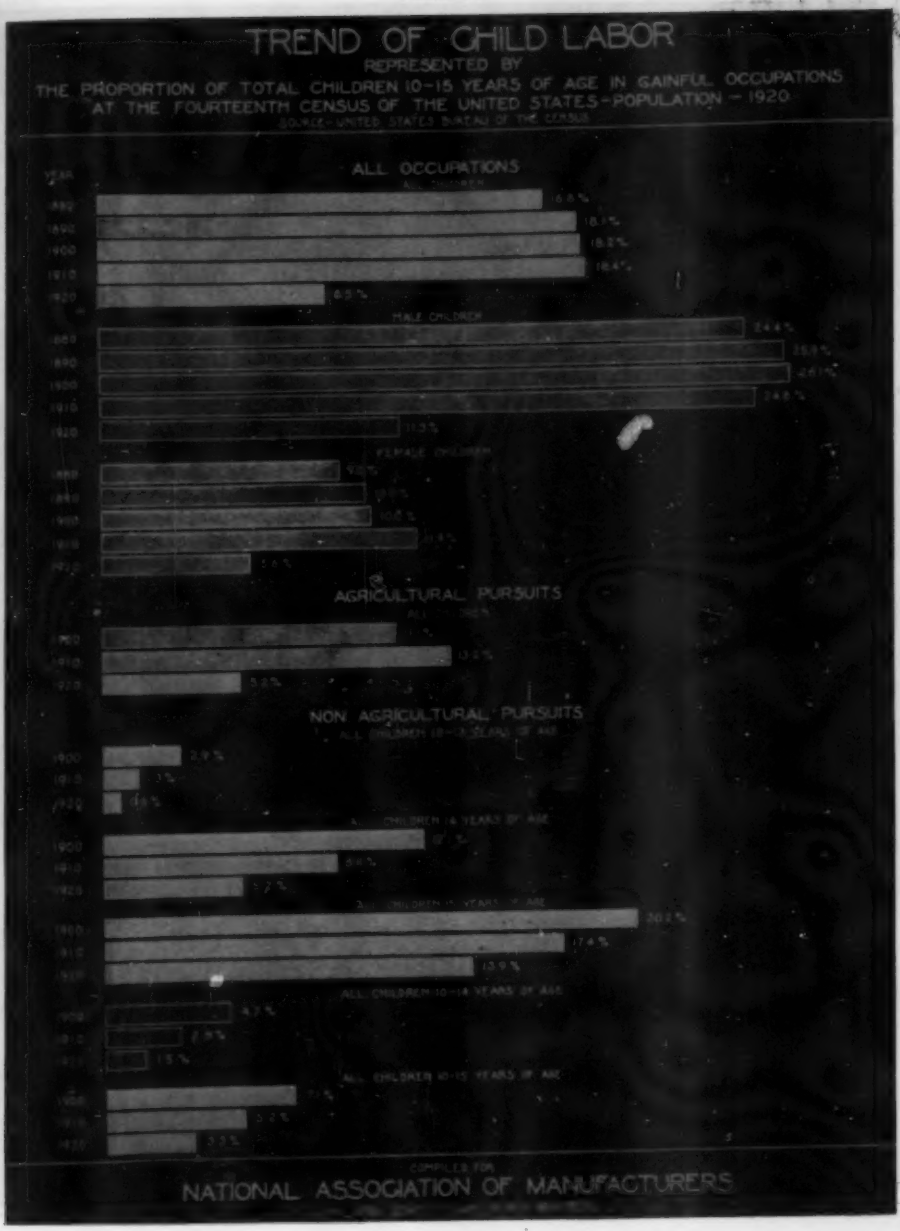

TREND OF CHILD LABOR
REPRESENTED BY
THE PROPORTION OF TOTAL CHILDREN 10-15 YEARS OF AGE IN GAINFUL OCCUPATIONS
AT THE FOURTEENTH CENSUS OF THE UNITED STATES - POPULATION - 1920
SOURCE - UNITED STATES BUREAU OF THE CENSUS
ALL OCCUPATIONS
MALE CHILDREN
FEMALE CHILDREN
AGRICULTURAL PURSUITS
NON AGRICULTURAL PURSUITS
COMPILED FOR
NATIONAL ASSOCIATION OF MANUFACTURERS

CHART II

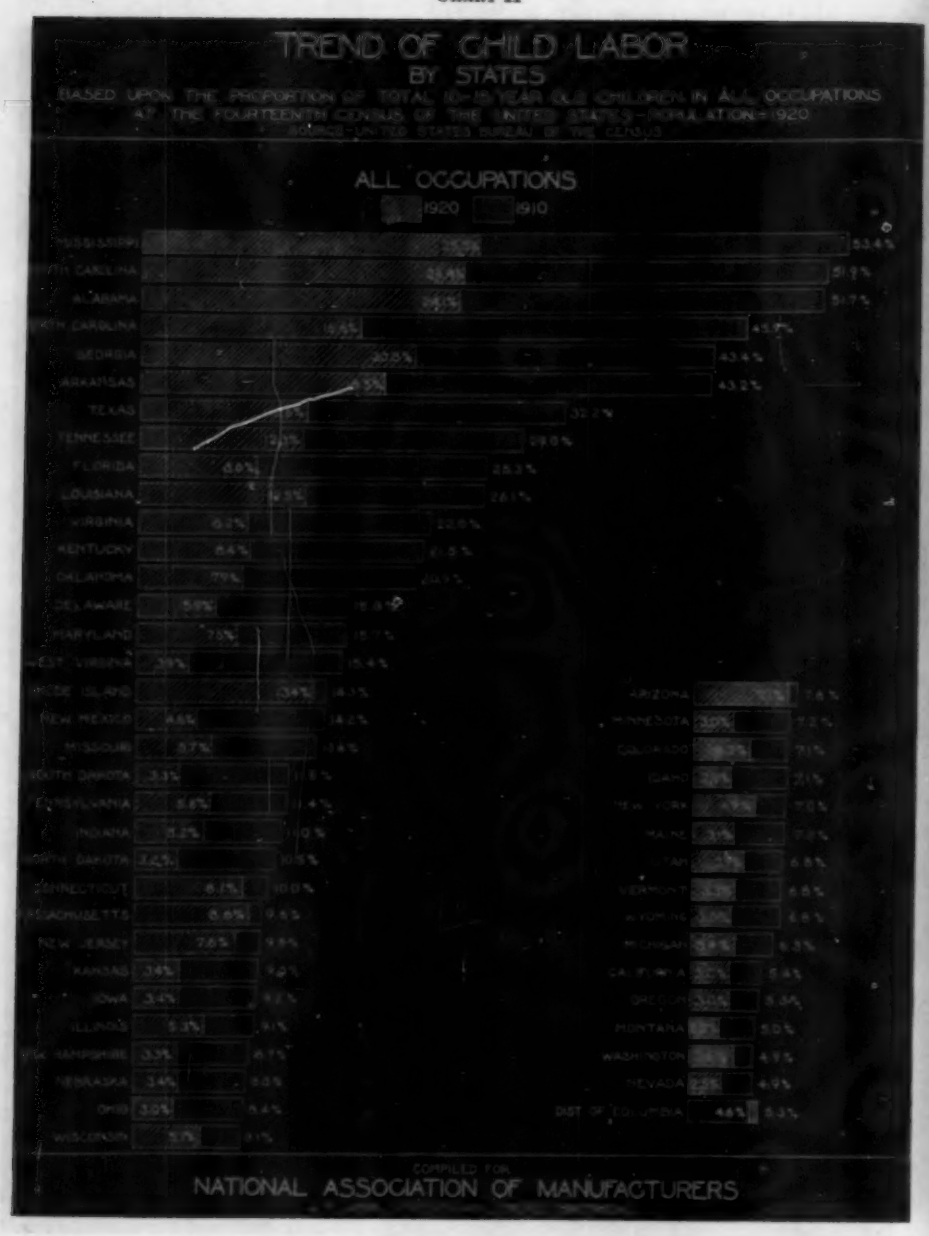
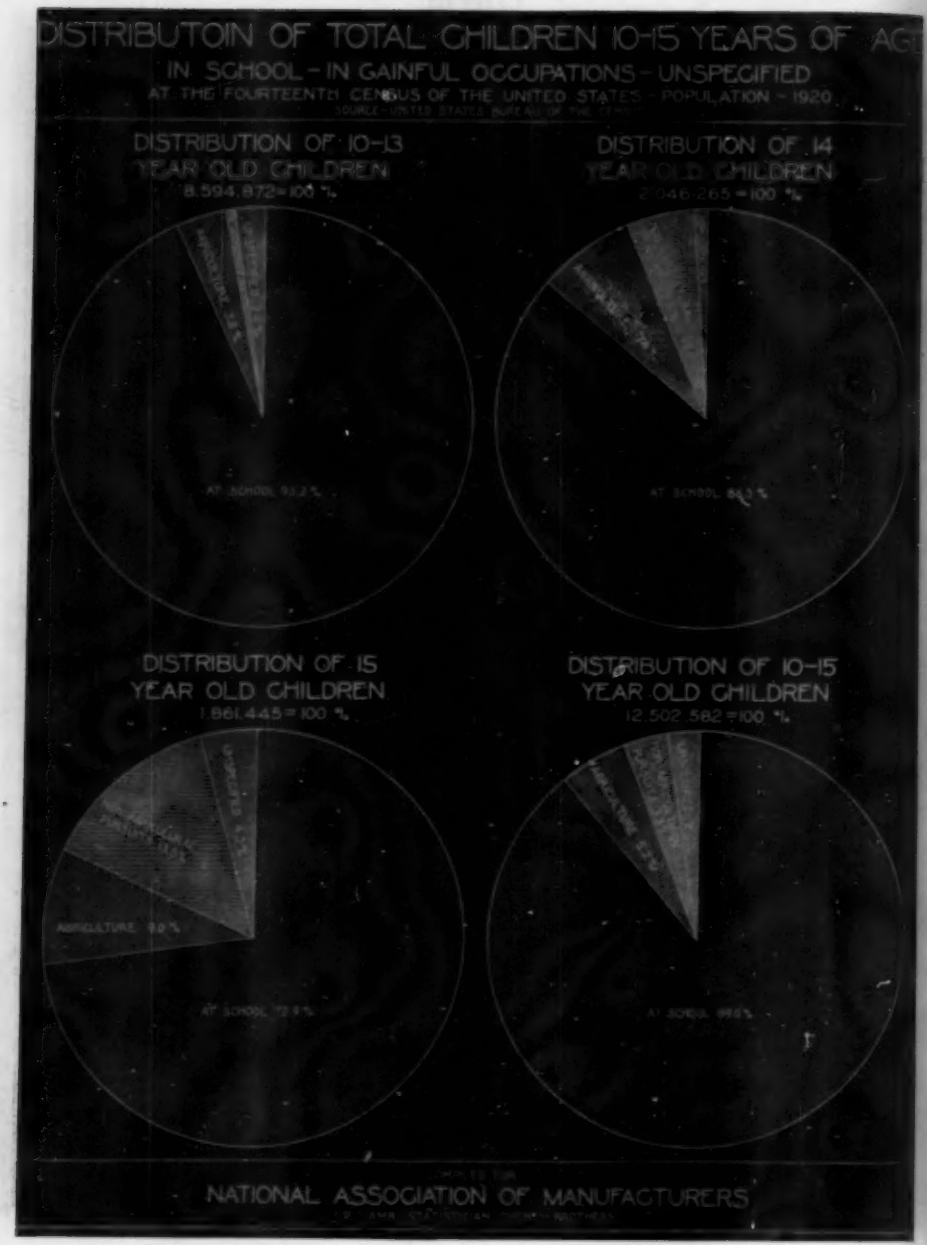

TREND OF CHILD LABOR
BY STATES
BASED UPON THE PROPORTION OF TOTAL 10-15 YEAR OLD CHILDREN IN ALL OCCUPATIONS AT THE FOURTEENTH CENSUS OF THE UNITED STATES - POPULATION - 1920
SOURCE-UNITED STATES BUREAU OF THE CENSUS
ALL OCCUPATIONS
1920
1910
MISSISSIPPI
SOUTH CAROLINA
ALABAMA
NORTH CAROLINA
GEORGIA
ARKANSAS
TEXAS
TENNESSEE
FLORIDA
LOUISIANA
VIRGINIA
KENTUCKY
OKLAHOMA
DELAWARE
MARYLAND
WEST VIRGINIA
RHODE ISLAND
NEW MEXICO
MISSOURI
NORTH DAKOTA
PENNSYLVANIA
INDIANA
SOUTH DAKOTA
CONNECTICUT
MASSACHUSETTS
NEW JERSEY
KANSAS
IOWA
ILLINOIS
NEW HAMPSHIRE
NEBRASKA
OHIO
WISCONSIN
ARIZONA
MINNESOTA
COLORADO
IDAHO
NEW YORK
MAINE
UTAH
VERMONT
WYOMING
MICHIGAN
CALIFORNIA
OREGON
MONTANA
WASHINGTON
NEVADA
DIST OF COLUMBIA
COMPILED FOR
NATIONAL ASSOCIATION OF MANUFACTURERS

CHART III


COMPARATIVE IMPORTANCE OF CHILD LABOR IN INDUSTRY
BY
AGE AND INDUSTRIAL GROUPS
AT THE FOURTEENTH CENSUS OF THE UNITED STATES - POPULATION 1920
ALL OCCUPATIONS
AGRICULTURAL PURSUITS
NON AGRICULTURAL PURSUITS
AGRICULTURAL PURSUITS
EXTRACTION OF MINERALS
TRANSPORTATION
TRADE
PUBLIC SERVICE
PROFESSIONAL SERVICE
DOMESTIC & PERSONAL
CLERICAL OCCUPATIONS
MANUFACTURING AND MECHANICAL INDUSTRIES
TEXTILE INDUSTRIES
NATIONAL ASSOCIATION OF MANUFACTURERS

CHART IV


DISTRIBUTOIN OF TOTAL CHILDREN 10-15 YEARS OF AG
IN SCHOOL - IN GAINFUL OCCUPATIONS - UNSPECIFIED
AT THE FOURTEENTH CENSUS OF THE UNITED STATES - POPULATION - 1920
DISTRIBUTION OF 10-13 YEAR OLD CHILDREN
8,594,872=100 %
DISTRIBUTION OF 14 YEAR OLD CHILDREN
2,046,265=100 %
DISTRIBUTION OF 15 YEAR OLD CHILDREN
1,861,445=100 %
AGRICULTURE 9.0 %
DISTRIBUTION OF 10-15 YEAR OLD CHILDREN
12,502,582=100 %
NATIONAL ASSOCIATION OF MANUFACTURERS

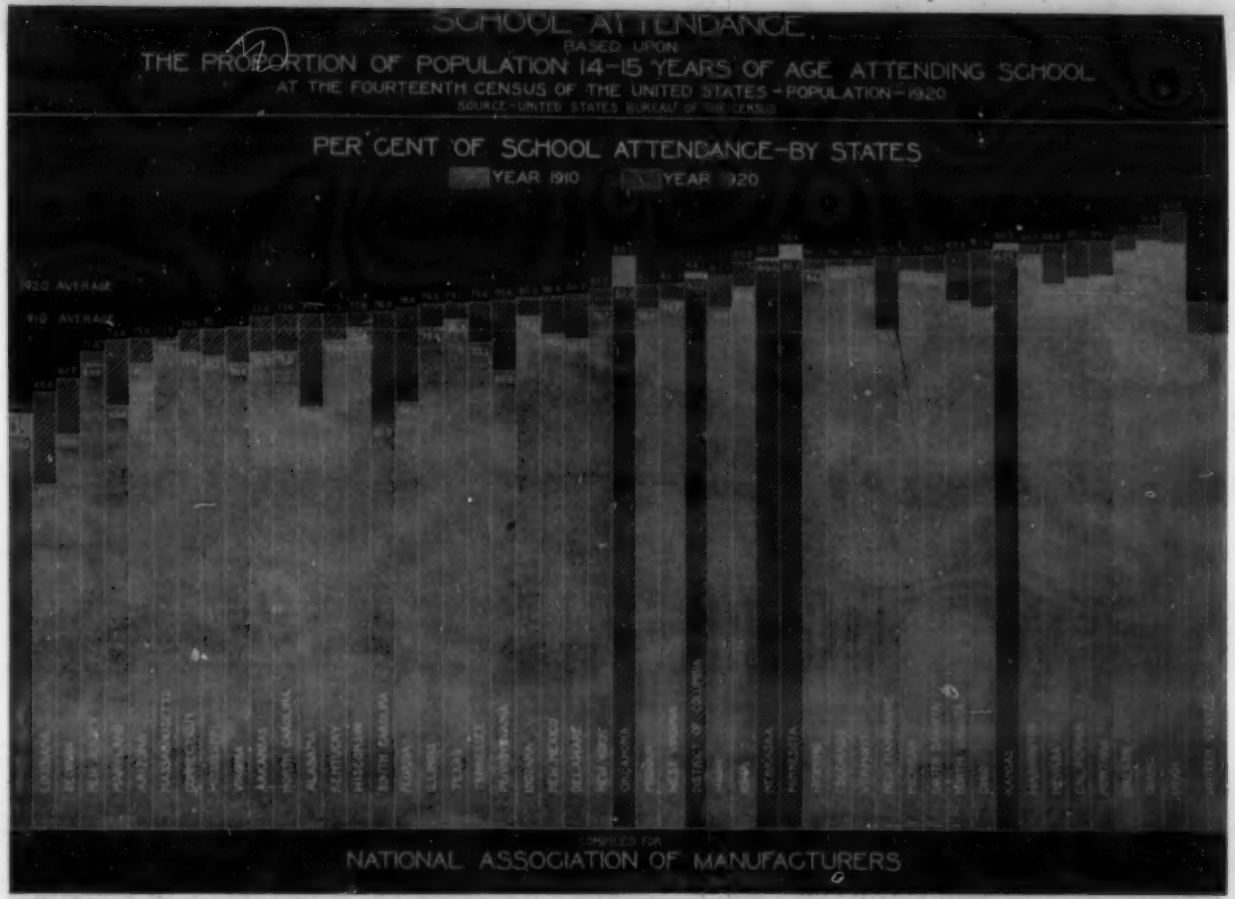

SCHOOL ATTENDANCE
BASED UPON
THE PROPORTION OF POPULATION 14-15 YEARS OF AGE ATTENDING SCHOOL
AT THE FOURTEENTH CENSUS OF THE UNITED STATES - POPULATION - 1920
SOURCE - UNITED STATES BUREAU OF THE CENSUS
PER CENT OF SCHOOL ATTENDANCE - BY STATES
YEAR 1910
YEAR 1920
1920 AVERAGE
910 AVERAGE
COMPILED FOR
NATIONAL ASSOCIATION OF MANUFACTURERS

CHART V

Chart VI

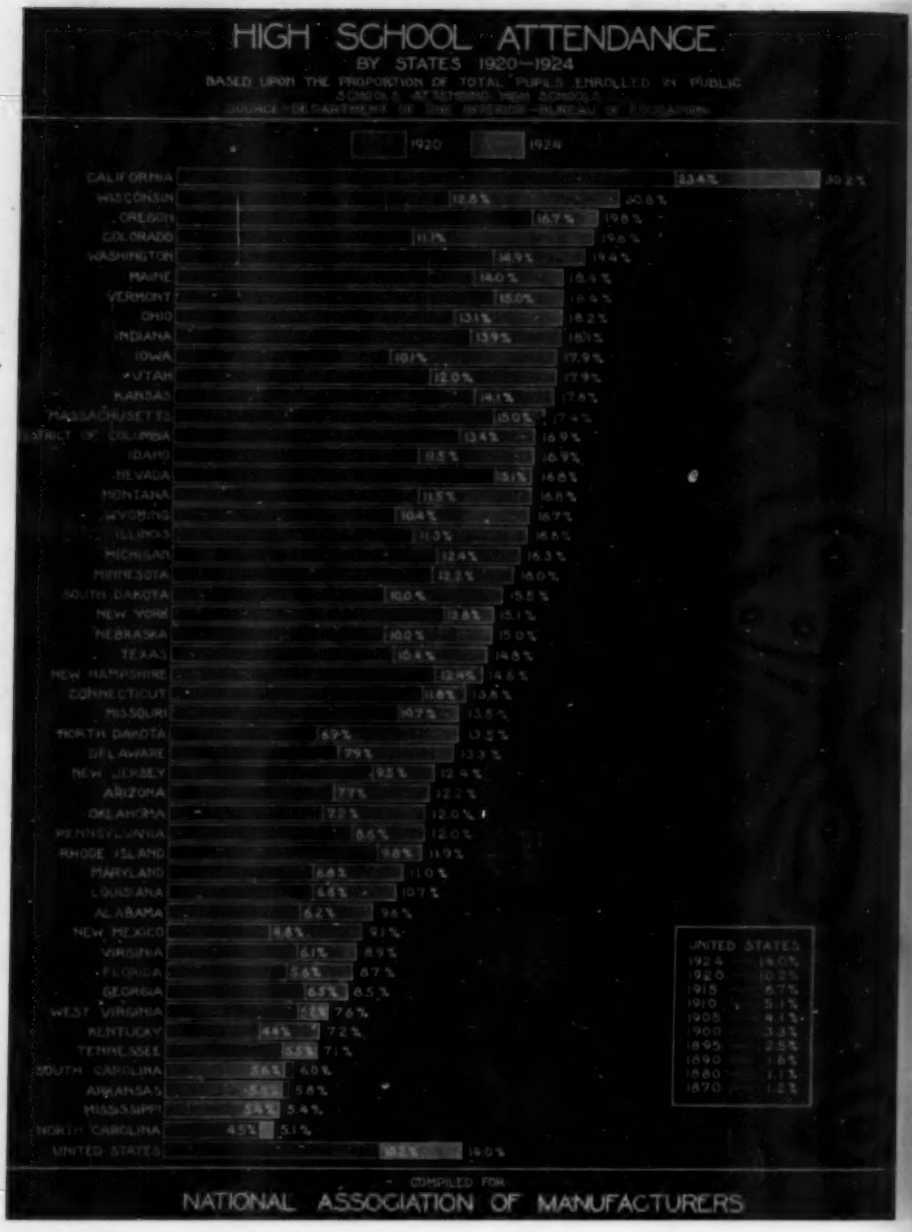

HIGH SCHOOL ATTENDANCE
BY STATES 1920—1924
BASED UPON THE PROPORTION OF TOTAL PUPILS ENROLLED IN PUBLIC SCHOOLS ATTENDING HIGH SCHOOLS
SOURCE: DEPARTMENT OF THE INTERIOR—BUREAU OF EDUCATION
1920
1924
CALIFORNIA 23.4% 30.2%
WISCONSIN 12.8% 20.8%
OREGON 16.7% 19.8%
COLORADO 11.1% 19.6%
WASHINGTON 14.9% 19.4%
MAINE 14.0% 18.4%
VERMONT 15.0% 18.4%
OHIO 13.1% 18.2%
INDIANA 13.9% 18.1%
IOWA 10.1% 17.9%
UTAH 12.0% 17.9%
KANSAS 14.1% 17.8%
MASSACHUSETTS 15.0% 17.4%
DISTRICT OF COLUMBIA 12.4% 16.9%
IDAHO 11.5% 16.9%
NEVADA 5.1% 16.8%
MONTANA 11.5% 16.8%
WYOMING 10.4% 16.7%
ILLINOIS 11.3% 16.6%
MICHIGAN 12.4% 16.3%
MINNESOTA 12.2% 16.0%
SOUTH DAKOTA 10.0% 15.8%
NEW YORK 12.8% 15.1%
NEBRASKA 10.0% 15.0%
TEXAS 10.4% 14.8%
NEW HAMPSHIRE 12.4% 14.6%
CONNECTICUT 11.8% 13.6%
MISSOURI 10.7% 13.5%
NORTH DAKOTA 6.9% 13.5%
DELAWARE 7.9% 13.3%
NEW JERSEY 9.2% 12.4%
ARIZONA 7.7% 12.2%
OKLAHOMA 7.2% 12.0%
PENNSYLVANIA 8.6% 12.0%
RHODE ISLAND 9.8% 11.9%
MARYLAND 6.8% 11.0%
LOUISIANA 6.8% 10.7%
ALABAMA 6.2% 9.6%
NEW MEXICO 4.8% 9.1%
VIRGINIA 6.1% 8.9%
FLORIDA 5.6% 8.7%
GEORGIA 6.5% 8.5%
WEST VIRGINIA 7.6% 7.6%
KENTUCKY 4.4% 7.2%
TENNESSEE 5.5% 7.1%
SOUTH CAROLINA 5.6% 6.0%
ARKANSAS 5.8% 5.8%
MISSISSIPPI 5.4% 5.4%
NORTH CAROLINA 4.5% 5.1%
UNITED STATES 10.2% 14.0%
UNITED STATES
1924 14.0%
1920 10.2%
1915 6.7%
1910 5.1%
1905 4.1%
1900 3.3%
1895 2.5%
1890 1.8%
1880 1.1%
1870 .7%
COMPILED FOR
NATIONAL ASSOCIATION OF MANUFACTURERS

Chart VII

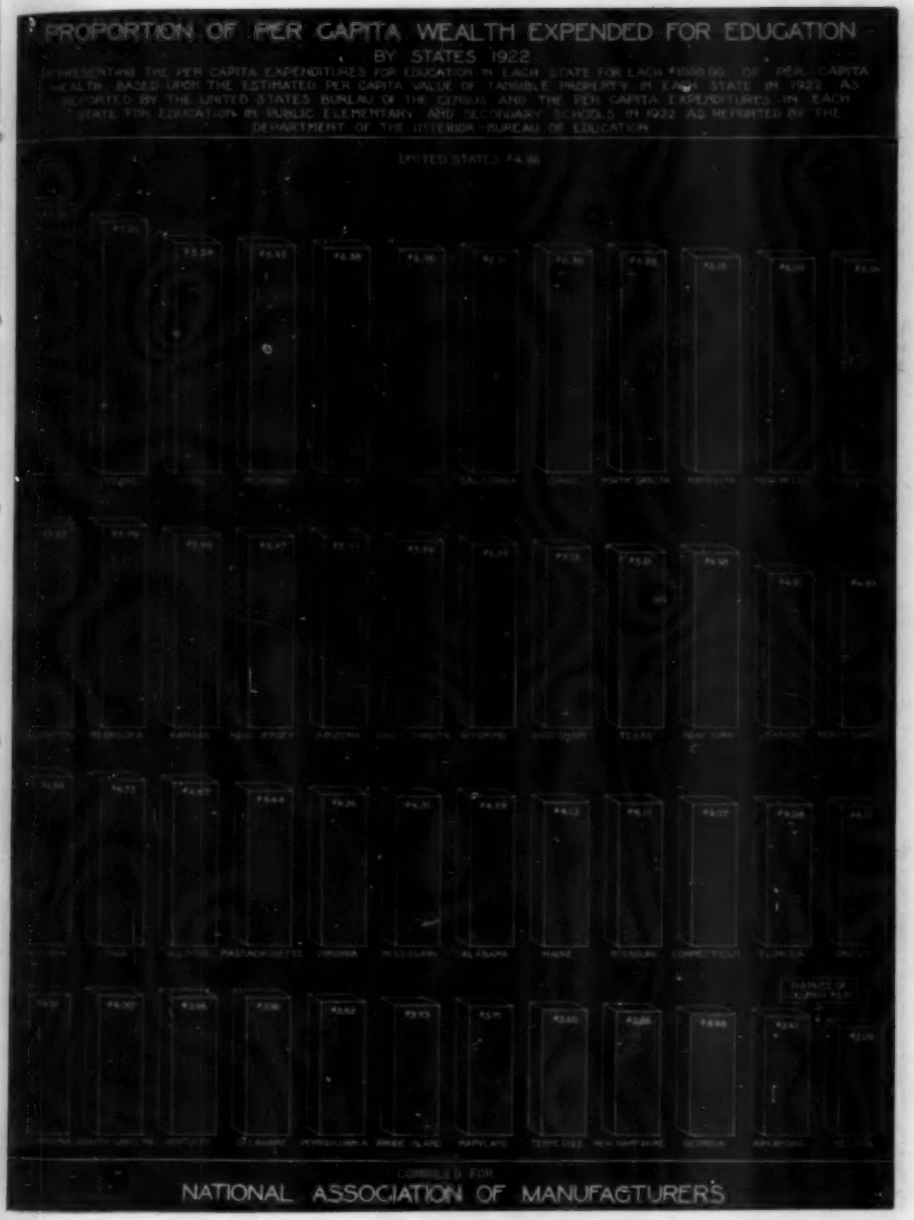

PROPORTION OF PER CAPITA WEALTH EXPENDED FOR EDUCATION
BY STATES 1922
REPRESENTING THE PER CAPITA EXPENDITURES FOR EDUCATION IN EACH STATE FOR EACH $1000.00 OF PER CAPITA WEALTH BASED UPON THE ESTIMATED PER CAPITA VALUE OF TAXABLE PROPERTY IN EACH STATE IN 1922 AS REPORTED BY THE UNITED STATES BUREAU OF THE CENSUS AND THE PER CAPITA EXPENDITURES IN EACH STATE FOR EDUCATION IN PUBLIC ELEMENTARY AND SECONDARY SCHOOLS IN 1922 AS REPORTED BY THE DEPARTMENT OF THE INTERIOR - BUREAU OF EDUCATION
UNITED STATES $4.86
COMPILED FOR
NATIONAL ASSOCIATION OF MANUFACTURERS

CHART VIII

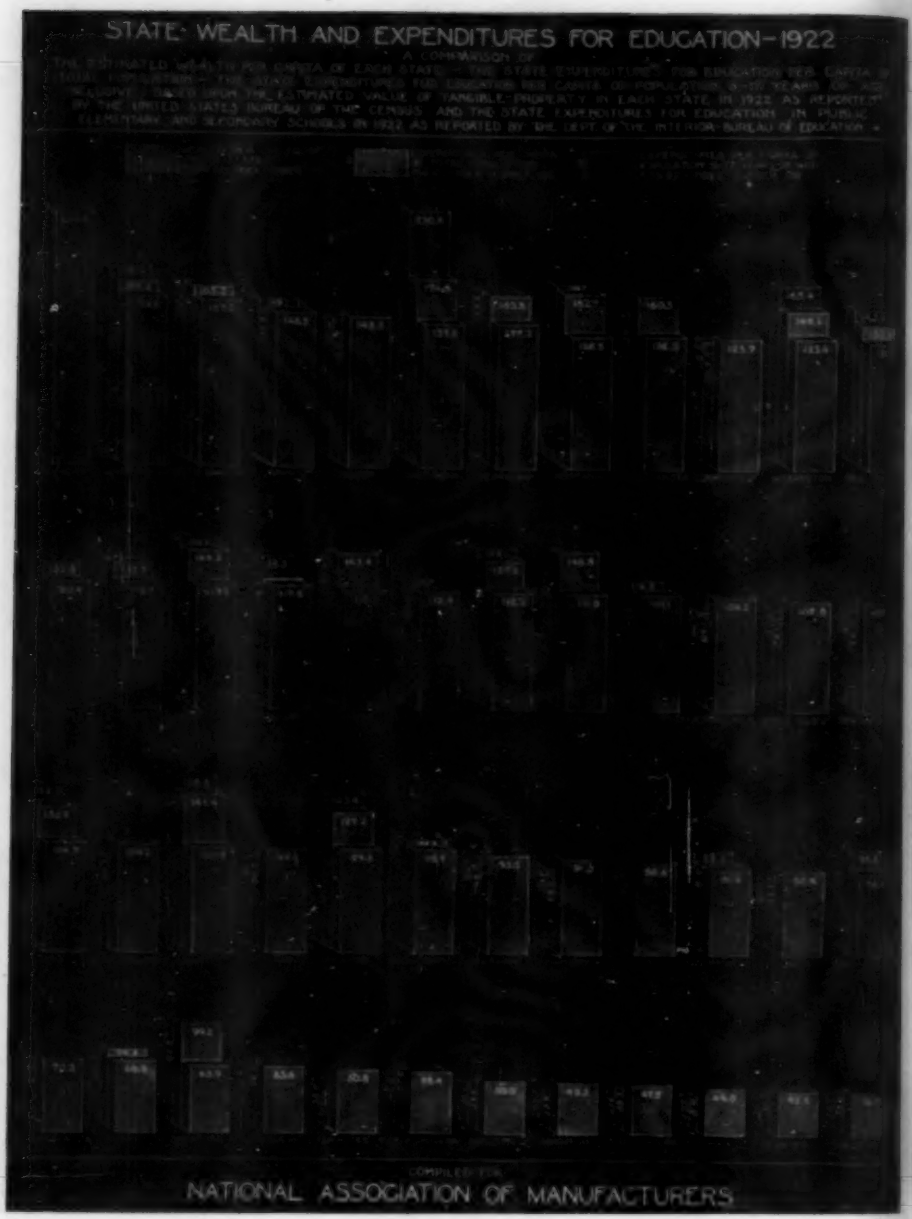

STATE WEALTH AND EXPENDITURES FOR EDUCATION-1922
A COMPARISON OF
NATIONAL ASSOCIATION OF MANUFACTURERS

CHART IX

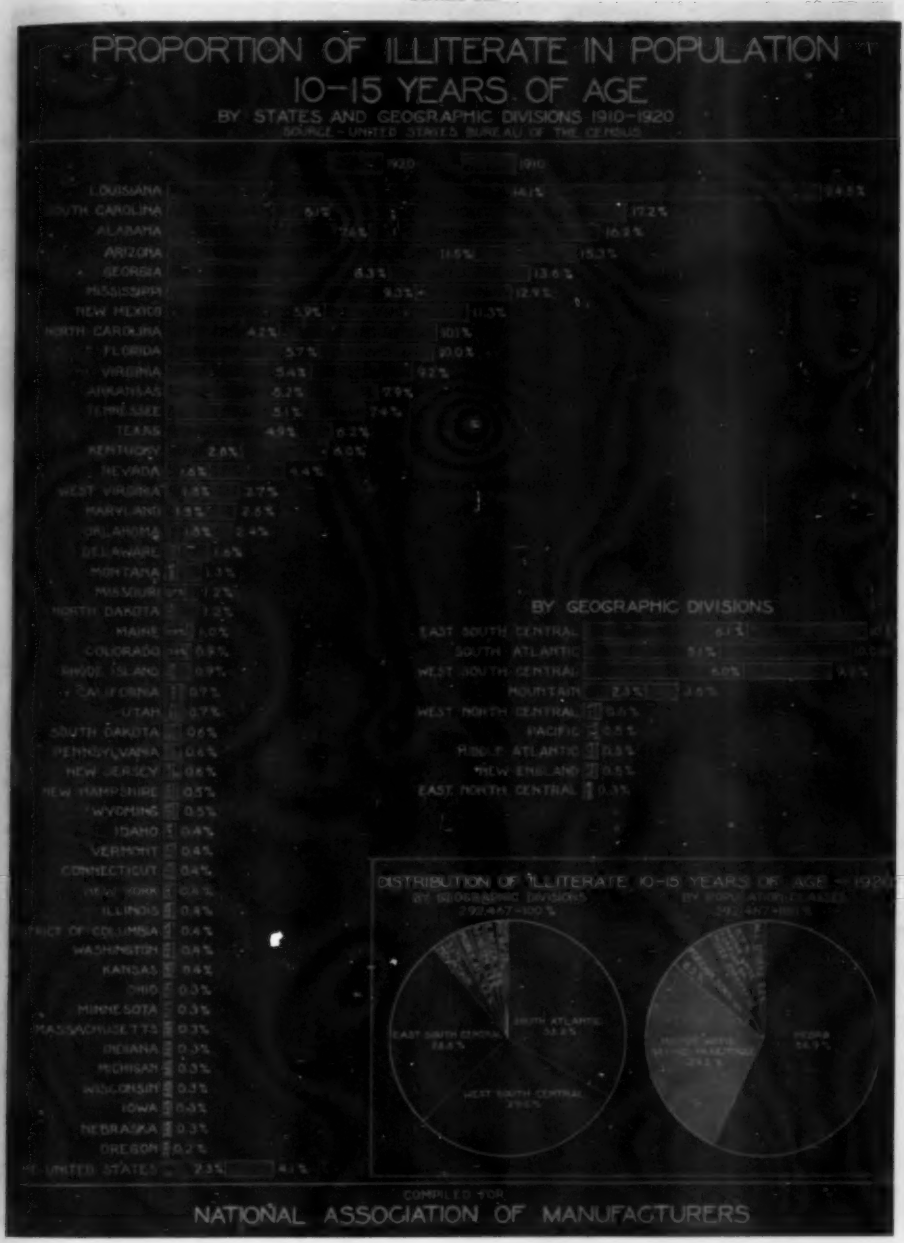

PROPORTION OF ILLITERATE IN POPULATION
10-15 YEARS OF AGE
BY STATES AND GEOGRAPHIC DIVISIONS 1910-1920
SOURCE - UNITED STATES BUREAU OF THE CENSUS
1920
1910
LOUISIANA
SOUTH CAROLINA
ALABAMA
ARIZONA
GEORGIA
MISSISSIPPI
NEW MEXICO
NORTH CAROLINA
FLORIDA
VIRGINIA
ARKANSAS
TENNESSEE
TEXAS
KENTUCKY
NEVADA
WEST VIRGINIA
MARYLAND
OKLAHOMA
DELAWARE
MONTANA
MISSOURI
NORTH DAKOTA
MAINE
COLORADO
RHODE ISLAND
CALIFORNIA
UTAH
SOUTH DAKOTA
PENNSYLVANIA
NEW JERSEY
NEW HAMPSHIRE
WYOMING
IDAHO
VERMONT
CONNECTICUT
NEW YORK
ILLINOIS
DISTRICT OF COLUMBIA
WASHINGTON
KANSAS
OHIO
MINNESOTA
MASSACHUSETTS
INDIANA
MICHIGAN
WISCONSIN
IOWA
NEBRASKA
OREGON
THE UNITED STATES
BY GEOGRAPHIC DIVISIONS
EAST SOUTH CENTRAL
SOUTH ATLANTIC
WEST SOUTH CENTRAL
MOUNTAIN
WEST NORTH CENTRAL
PACIFIC
MIDDLE ATLANTIC
NEW ENGLAND
EAST NORTH CENTRAL
DISTRIBUTION OF ILLITERATE 10-15 YEARS OF AGE - 1920
BY GEOGRAPHIC DIVISIONS
292,447 = 100 %
EAST SOUTH CENTRAL
SOUTH ATLANTIC
WEST SOUTH CENTRAL
BY RURAL-URBAN AREAS
292,447 = 100 %
RURAL
COMPILED FOR
NATIONAL ASSOCIATION OF MANUFACTURERS

Chart X

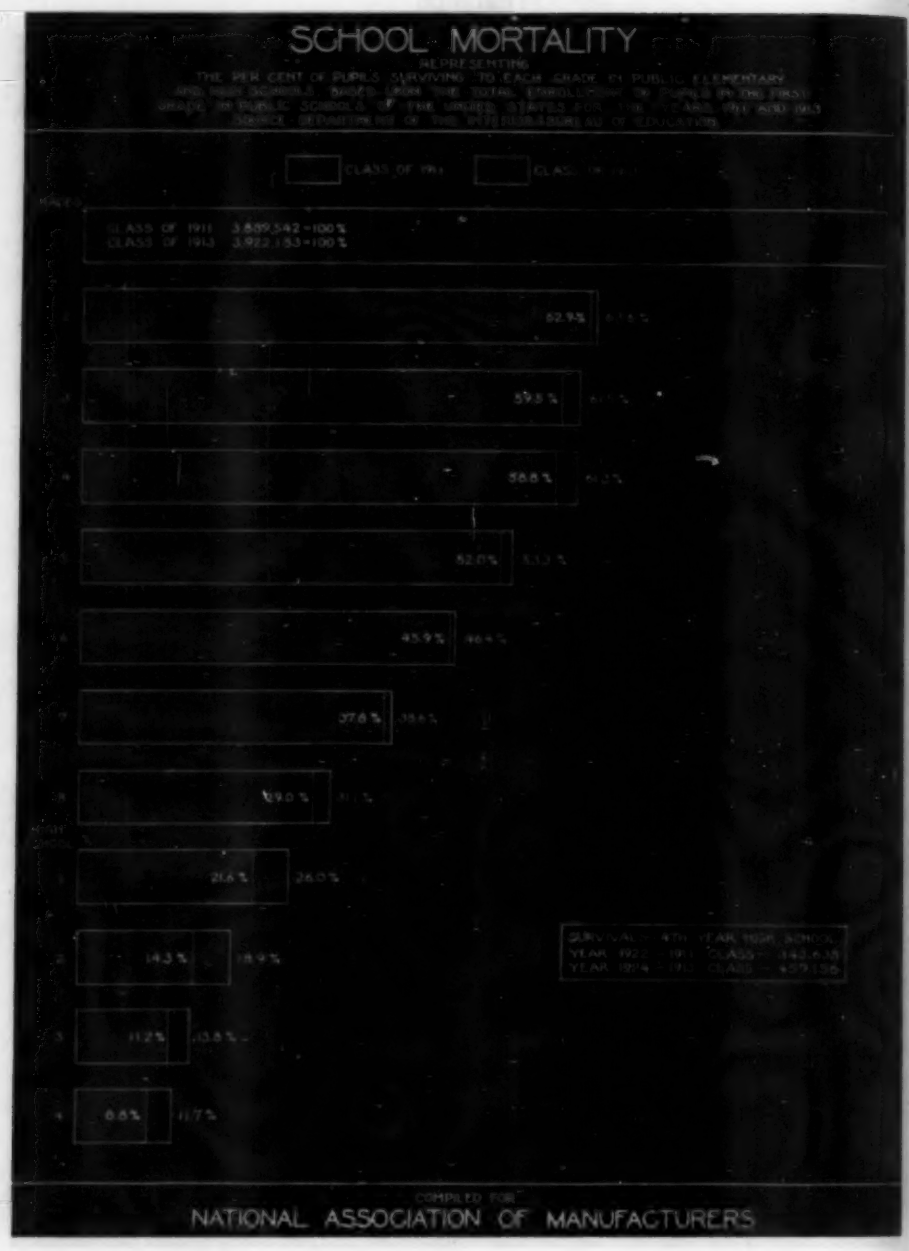

SCHOOL MORTALITY
REPRESENTING
THE PER CENT OF PUPILS SURVIVING TO EACH GRADE IN PUBLIC ELEMENTARY
AND HIGH SCHOOLS, BASED UPON THE TOTAL ENROLLMENT OF PUPILS IN THE FIRST
GRADE OF PUBLIC SCHOOLS OF THE UNITED STATES FOR THE YEARS 1911 AND 1913
SOURCE REPORTS OF THE BUREAU OF EDUCATION
CLASS OF 1911
CLASS OF 1913
CLASS OF 1911 3,809,542=100%
CLASS OF 1913 3,922,153=100%
82.9%
59.5%
56.8%
52.0%
45.9%
37.8%
29.0%
21.6%
26.0%
14.3%
18.9%
11.2%
13.8%
8.8%
11.7%
COMPILED FOR
NATIONAL ASSOCIATION OF MANUFACTURERS

CHART XI

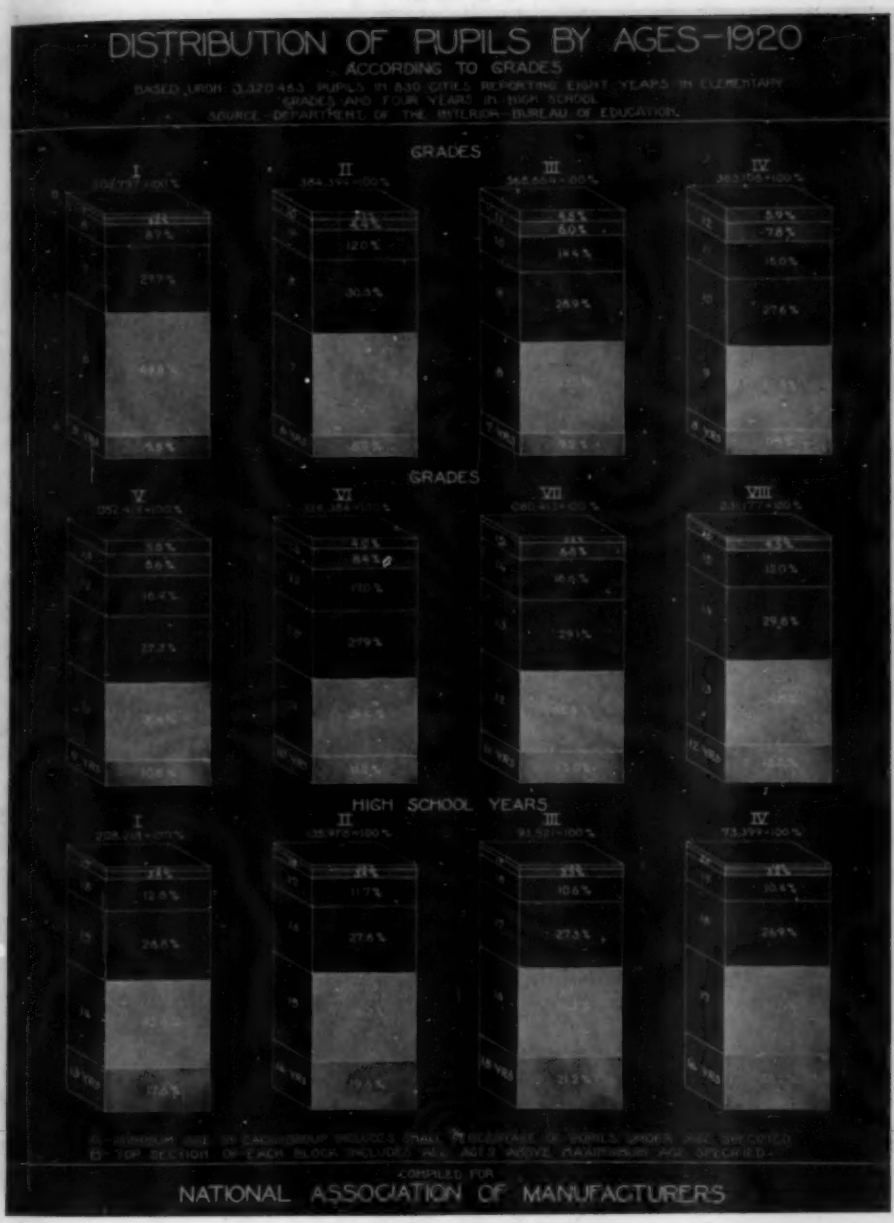
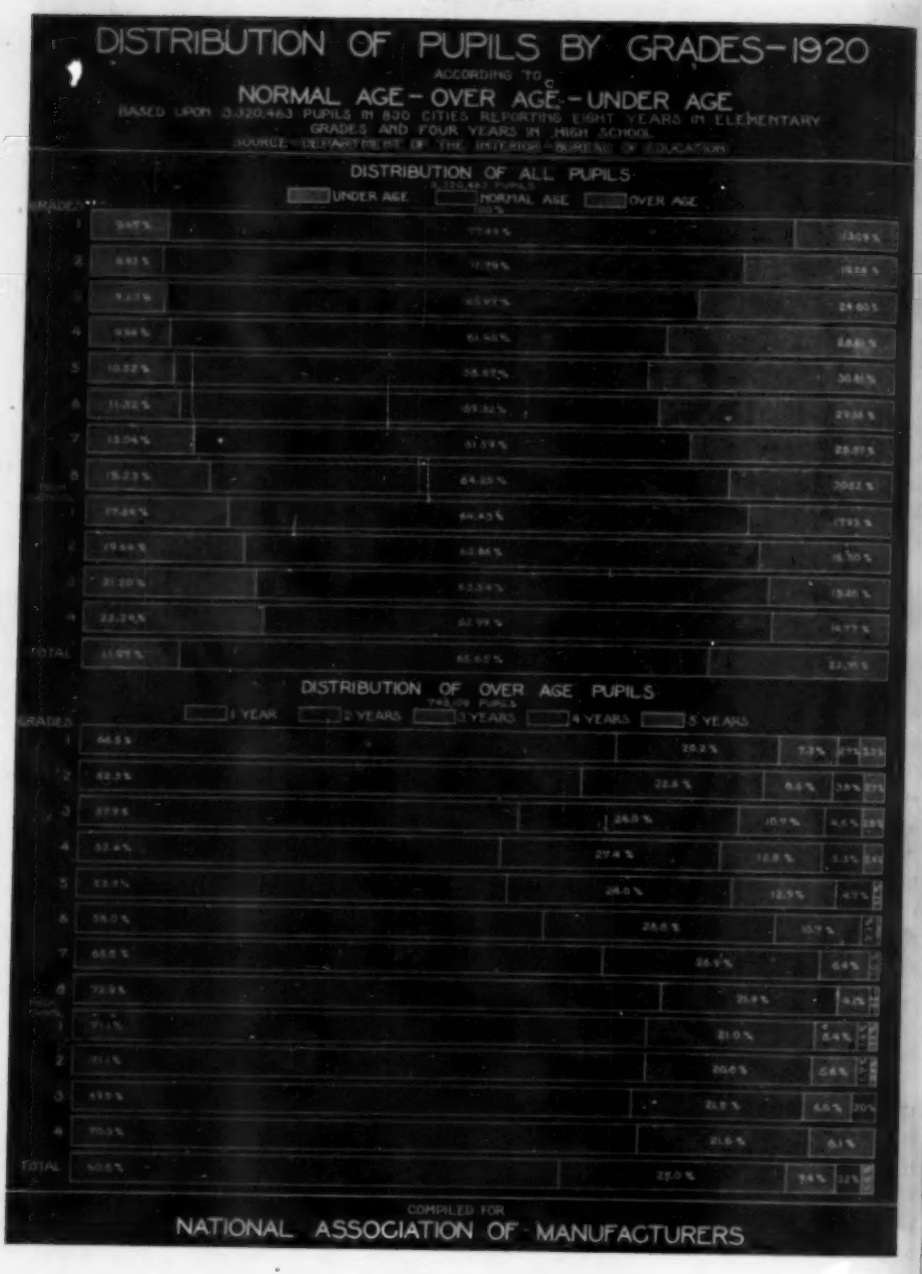

DISTRIBUTION OF PUPILS BY AGES—1920
ACCORDING TO GRADES
BASED UPON 3,320,463 PUPILS IN 830 CITIES REPORTING EIGHT YEARS IN ELEMENTARY GRADES AND FOUR YEARS IN HIGH SCHOOL
SOURCE: DEPARTMENT OF THE INTERIOR—BUREAU OF EDUCATION
GRADES
I
II
III
IV
GRADES
V
VI
VII
VIII
HIGH SCHOOL YEARS
I
II
III
IV
COMPILED FOR
NATIONAL ASSOCIATION OF MANUFACTURERS

CHART XII


DISTRIBUTION OF PUPILS BY GRADES-1920
ACCORDING TO
NORMAL AGE - OVER AGE - UNDER AGE
BASED UPON 3,320,463 PUPILS IN 830 CITIES REPORTING EIGHT YEARS IN ELEMENTARY GRADES AND FOUR YEARS IN HIGH SCHOOL
SOURCE - DEPARTMENT OF THE INTERIOR - BUREAU OF EDUCATION
DISTRIBUTION OF ALL PUPILS
3,320,463 PUPILS
UNDER AGE
NORMAL AGE
OVER AGE
100%
GRADES
1
2
3
4
5
6
7
8
HIGH SCHOOL
1
2
3
4
TOTAL
DISTRIBUTION OF OVER AGE PUPILS
743,109 PUPILS
1 YEAR
2 YEARS
3 YEARS
4 YEARS
5 YEARS
COMPILED FOR
NATIONAL ASSOCIATION OF MANUFACTURERS

The State's Responsibility Toward Child Labor Legislation

By Paul U. Kellogg
Editor of *The Survey*

I WONDER if one newspaper reader in ten realizes that we are witnessing not one, but two issues of public control bearing down the road of self-government in opposite directions: Federal prohibition enforcement and state child labor enforcement. Contrary to all the laws of processions, the wetter the issue the more dust it kicks up. The working children of the country are almost lost to sight in the rumpus; they might seem to be on a bypath, but if we look closer they are on the main highway.

In prohibition we are testing out the enforcibility of a scheme of Federal control in the touchiest and most exasperating area of governmental interference—the habits of adults. We adopted it in the high names of health and morals.

In protective labor legislation, we are testing out the sufficiency of a scheme of state control with respect to the most precious of our potential national assets—the conservation of children. And we have remanded it to the states in the high names of freedom and self-government.

Incidentally, we so remanded it not on its merits, but as a back-kick against prohibition.

Now everybody can get off a wise crack about prohibition enforcement; the thing is dramatized with rum-running and the gun play of high binders, and police dogs guarding precarious cellars in respectable neighborhoods. It is personalized, and tens of thousands of agitated citizens have rediscovered their love of liberty in the pit of their stomachs. But child labor is more remote from the sources and stages and springs of public concern.

If what happens to a wage-earning boy or girl were as near to us as what happens to our drinks; if the courts were clogged with suits for damages for wasted childhood, and stinted talents, and life-long handicaps as they are with liquor cases; if the headlines over the shooting-up of the organizer of a bootleg gang by his rivals were matched by those over the neglect of a state that lets fifty minors—boys and girls—be killed in its industries in a single year, then we might be as keenly aroused over this question of state enforcement where children are concerned as we are over the question of Federal enforcement where whiskey and beer are concerned.

Child labor and the Federal Government was the issue before the country two years ago when the 20th Amendment was up in most of the state legislatures, and was turned down, or passed over by all but four of them. That question will come back if the states fail to act. The child labor issue will not be settled until it is settled in an enduring way. But the question as it stands before the country now, with forty-four legislatures convening this winter, is not ratification of the Federal amendment, but what further the states are going to do themselves with respect to child labor within their own borders.

One of the tests of whether a state comes within what is called the regis-

tration area, in the matter of the vital statistics that would put us on a par with other progressive nations, is whether or not it keeps accurate tally of the babies born to its citizens. If it takes the trouble to register ninety per cent of their births it is included. The states which fall below this standard are:

Alabama, Arkansas, Colorado, Georgia, Idaho, Louisiana, Missouri, Nevada, New Mexico, Oklahoma, South Carolina, South Dakota, Tennessee, and Texas.

Accurate birth registration is more than a matter of statistics. It is a prerequisite of any state child labor law that has any teeth in it. Its absence undermines the enforcement of an age standard. It leaves a hole big enough for bus-loads of under-age children to be driven through the provisions of a law by ignorant parents or grasping employers. On the other hand, it makes it difficult for the over-age child to get "working papers," and if he is injured he may not be able to prove his age in those states where illegally employed children have no claim for compensation.

SHORTCOMINGS IN COMPENSATION LAWS

Let me take up this matter of compensation, because it lies outside the provisions of most child labor laws, and so is a fairly independent index of how far serious local concern for protecting children (on which we must lean if we rely on state action for regulating the employment of minors) has gone not only in many of the so-called backward states, but in states midway in the roll of child conservation.

And if I point out something of the shortcomings of our compensation laws, it is not because I am not ardently a believer in the constructive statesmanship that conceived them, the sincere, difficult and largely unappreciated service that often goes into their execution, as at the hands of the present Pennsylvania Compensation Commission.

The French, who seem to be able to combine national action with a measure of liberty that has associated them with that word in the idealism of the Western World, have a law that, when a workman is permanently disabled, the amount of compensation shall be based on the number of years he is likely to live according to the insurance tables. An old man would thus receive a comparatively small award, and a minor would receive a much larger award because he has normally to suffer loss from his mutilation over many more years than an old man. But our American compensation laws have not adopted this reasonable principle to date. No mere money can ever compensate a boy or girl for the loss of an arm, or a leg, or an eye. Yet under our compensation laws they recover sums based on their juvenile wage rates. Such awards are very slight. They do not stimulate employers, who are virtually all insured against this cost, to adopt the strictest safety measures. If you kill a man's cow, or smash his Ford, its probable longevity will make the killing and the smashing come higher. But not if you kill or maim his boy.

Moreover, twelve states throw the lever the other way round. They exclude from compensation minors who are illegally employed. These states are:

Delaware, Illinois, Iowa, Louisiana, Minnesota, Nebraska, Oklahoma, Pennsylvania, Rhode Island, South Dakota, Vermont, and West Virginia.

What is the use of enacting measures protecting child workers, if you

specifically free violators of those laws from paying the penalty of their carelessness of life and limb when it comes to boys and girls they have broken the law to employ?[1]

The Consumers' League of Pennsylvania, with the aid of the Pennsylvania Department of Labor, has given us some facts as to what this situation means in one great industrial state in one year.

The year studied was 1923. In that year

Ten working children under fourteen years of age were injured at their work.

Four less than sixteen years of age were killed at their work.

Fifty-one sixteen and seventeen years of age were killed at their work.

Eighty-one of that age were permanently disabled at their work.

One hundred and fifty-two of that age suffered amputations because of accidents in their work.

Read the stories they have brought together of the suffering, the blighted hopes, the broken lives, the struggles and frustration of these boys and girls.

But there is another side to this shield. It is possible not only to prohibit the employment of young children, but to prohibit the employment of minors in dangerous pursuits. And it is possible to hold to book the ruthless employer, who gets the business edge on his competitors by cutting under the protective laws to get cheaper help. In New Jersey and New York he must pay double compensation to minors injured while illegally employed. In Wisconsin he has to pay double to minors injured while at work in lawful employments but without the required permit. And in Wisconsin he must pay treble for minors injured in prohibited employments. The Wisconsin experience, and coupled with it the more recent New York experience, shows that this is a most effective stimulus to the obedience of child labor laws.

These facts about the progressive states (and not a little of my other data) I got from Mrs. Florence Kelley of the National Consumers' League, our most indefatigable champion of child labor legislation; and so I suppose that it was Moscow gold at Trenton and Albany and Madison that is bringing relief—if not restitution—to working boys and girls in those states who have had tendons torn in the day's work, or hands cut to a stump at the wrist; has brought safety to countless others. And in spite of the raucous opposition of some manufacturers and some manufacturers' associations, there has been many a forward looking employer who has thrown his weight, along with the

[1] It should be pointed out that damage suits can be brought in some of these cases, that is, cases where children illegally employed are injured. Ordinarily in Pennsylvania, I am informed, the employer when a self-insurer, or the insurance company carrying the employer's insurance will enter into a compensation agreement regardless of the question of illegal employment. One of the inducements for entering into such an agreement lies in the fact that such cases make excellent material for damage suits and it has been held by the Pennsylvania courts that a compensation agreement, executed and carried into effect by the payment of compensation, will bar a suit for damages until set aside by the Compensation Board. The occasional cases that have come before the Compensation Board involving illegal employment are all based upon efforts made by a claimant who has entered into a compensation agreement to have it set aside in order that the way may be clear for an action for damages. The Compensation Board has been averse to setting the agreements aside. The returns from compensation, though limited, are reasonably certain while those from an accident suit are highly speculative. Chairman T. Henry Walnut of the Pennsylvania Commission favors the amendment of the law to cover illegally employed children and to include a penalty at least in those cases where the employment was knowingly entered into contrary to law.

labor unions and the social workers, and with citizens generally, behind such laws as those in Wisconsin and New Jersey and New York, behind the general child labor laws on the statute books of most of our states, behind the two Congressional acts which sought to set a national standard. Granted the conscientious principles of not a few, I suspect that some of the loudest opponents of the Federal amendment are equally opposed to state interference with hiring and firing, old or young. And yet there must have been, must be, some reasonable principle informing all these statutes which has appealed to so wide and varied a constituency of Americans, employers among them.

OPPOSITION TO GOVERNMENT ACTION

In the days when the first state laws were proposed, they were denounced as the entering wedge of a full-fledged socialism, just as two years ago the Amendment was damned from end to end of Massachusetts in paid advertisements as the camel's nose under the tent that would let in nationalization of children. As Americans, we delight in bogies; and when it comes to shivers up our spines, Hallowe'en rather than the Fourth of July is our natal day. If one were to judge by some of the present exponents of extreme individualism, of modern liberty, of warmed over states' rights and a rehashed *laissez-faire*, the pendulum has swung so far that we must throw out all social control through government action as a petty and fruitless attempt to settle things by passing laws, and consign it to the limbo of exploded theory. Just as, in the old days, your extreme socialist denounced such laws as palliatives, delaying the day of reckoning.

From one dogmatic extreme to the other the scarecrow has about-faced and blithers in the wind again. It has changed its coat, but it has the same old pants, and no legs in them. I refuse to see that it gets anywhere.

Rather, there has been something which appeals essentially to our American common sense, and constructive spirit, in the principle underlying our protective labor legislation of the last quarter century, of which our child labor laws are representative.

In a special sense our stout belief in opportunity for all vests in our hopes for children. We want them to have the chance we associate with the new world. We want our own child to have this chance. We want everybody's child to have this chance. And working our way slowly, out of a commonwealth of farmers and settlers into an industrial nation, we were confronted with the necessity of seeing to it that our children get that American chance under the changed conditions. On the one hand, we woke up to the waste, the misery, the suffering of children who had gone into mills and factories, we woke up to the realization that this was something outside our ken in village and countryside, and it stirred our wrath and concern. On the other hand, we have not taken kindly as a nation to schemes of government ownership. Our jealousy of the American opportunity entered in again. Socialism has been regarded as an imported theory. At all events the general run of people refused to choose between it as an immediate or desirable political goal and letting the human wastage in industry go forward,—as some of its extreme opponents, some of its extreme advocates, have argued they must choose.

We were confronted with somewhat the same problem in the sanitary housekeeping of our cities. A man's house was his castle. He owned his land, according to the old idea, from

heaven to hell. But when he built on his land a house for several families, a congregate dwelling in one of our great and growing urban centers, where the health of one affected the health of all, then the law stepped in. It didn't step in without a fight, and it had to be new law, based on a new principle. Witness the uproar over the first tenement house law—the churchly landlords and legal big-wigs that viewed it with alarm and fought it. But the law won. In the growing cities of our industrial epoch we set a bottom level. Below that level the state stepped in to regulate, to prohibit. Above that level a home builder had all the liberty in the world. Below that level were cellar dwellings, and unsanitary privies, and dark airshafts, and windowless rooms. The level had to do with light, fresh air, and water—things we had had freely in small communities.

SETTING A BOTTOM FLOOR IN INDUSTRY

So, if more slowly, came the movement to set a bottom floor for the new corporate American industry. Above that level, liberty: freedom to bargain as men pleased, opportunity to experiment in striking the balance between efficiency and democracy in industry; above that level opportunity to work out an industrial order consonant with our ideals as a people. The process is still on. But here and now by our industrial minimum standards we have subordinated not a few hoary abuses and new evils. We have condemned the 12-hour day and the 7-day week; we have outlawed unguarded machinery, night labor for women, the premature employment of children. We have set a bottom floor for American industry—and if an industry cannot operate above it we have a shrewd guess there is something the matter with the industry.

It is this principle of the minimum which will help win the support of all conditions of Americans in the fights still before us to prevent further human waste in industry. It can be relied on as a force in constructive public opinion in the efforts to secure state action in the field of child labor legislation.

I would do nothing to stay such action. I would do everything to energize it. The welfare of hundreds of thousands of children waits upon it, and the National Child Labor Committee is putting its expert service at the disposal of the states.

But I believe one of the most fruitful methods of energizing state action is to keep the Federal amendment alive as a possibility. And my profound conviction is that if the states do not act it will become more than a possibility; it will become a national issue again which will not be so easily downed a second time.

And I would point out that this principle of the industrial minimum is clarifying with respect to the controversy between Federal and state regulation. The Federal amendment is an enabling act. It would give Congress power which the courts denied Congress, but which the states themselves hold. Under such an amendment the states would still hold that power above whatever minimum level Congress might set for the country as a whole. And there are edged questions as to how long the conscience of the country shall have to wait for backward states to fall into line where so much of human treasure is at stake; how many commonwealths, new to industry, must learn what the older industrial states have learned to the cost of their youth. There is no factory so obscure that the children

it exploits do not become citizens of the United States. The business interests which get national tariffs, and national transportation systems, and national banking laws, cannot count indefinitely on popular palsy when it comes to something close to the people's hearts—once the people come to see what they can do about it. They cannot count on people failing to make distinctions between floor levels, and to see that we can readily ban our industrial sub-cellars and give free play to initiative above them—whether that distinction be written in a state law for manufacturing establishments within its borders, or whether that distinction be written broadly in a Federal act, setting a national minimum and giving the states free play in their law making and industrial practice above and beyond it.

When fourteen states seem to care so little for their children that they fail to register one out of ten of them; when six states, two of them (Missouri and North Carolina) with great manufacturing industries, have no compensation laws at all, so that maiming a child at work is cheaper than breaking a machine or spoiling a hank of raw material; when most states with compensation laws base their awards on wages, so that the younger the worker injured the less the employer has to pay; when at least seventeen states are so indifferent to industrial injuries to minors that they do not record them separately; and when twelve states, Pennsylvania among them, exclude from compensation all children illegally employed, thereby putting a premium on the outlaw employment of under-aged boys and girls —then it would seem that those who believe that state laws are sufficient to safeguard the oncoming generation of Americans have a heavy burden of proof to show that the states are alive to those children's interests. They will have to bestir themselves in securing state laws and state enforcements, adequate and country-wide, if they hope to keep down permanently the issue of national minimum standards protecting every growing boy and girl in America.

And those others who oppose such a course, not from conviction, but from a shortsighted selfish interest may not always have the prohibition issue to throw dust in the argument; nor Bolshevism as a bug-bear; nor be able to fool all the farmers all the time with the clap-trap that a Federal act will keep their sons from doing chores and their daughters from washing the dishes.

The Defeat of the Twentieth Amendment

By Thomas F. Cadwalader
Chairman, Sentinels of the Republic

THE proposed Twentieth Amendment to the Constitution of the United States, passed by more than two-thirds of the House of Representatives and of the Senate and submitted to the states on June 2, 1924, is practically conceded to have been defeated. Thirty-six of the state legislatures have definitely rejected or refused to ratify the amendment; four only have ratified. In one state, New Mexico, ratification was accomplished in the House, but no action has been taken in the Senate. Five state legislatures have adjourned without taking any action at all, and two, Maryland and Alabama, have had no session of their legislatures since the submission of the amendment. At least twenty states have certified to the State Department at Washington the fact that they have considered and rejected the amendment. Thirty-six ratifications are necessary for its adoption. It is apparent that they cannot be secured within any reasonable time, and as the Supreme Court has held that ratification must occur within a period that can be called contemporaneous with the proposal of the amendment by Congress, it is safe to say that this proposed amendment is dead.

This is the fifth amendment actually proposed by Congress that has failed of ratification. Two of the original twelve, submitted by the first Congress, failed of adoption by lack of one or two states, leaving the other ten to constitute what is commonly called the "Federal Bill of Rights." Another amendment proposed about 1812 to deprive of citizenship all persons accepting gifts or honors from foreign governments, likewise failed of adoption by a very narrow margin. The so-called Corwin Amendment, proposed in 1861, immediately prior to Lincoln's inauguration, in order to forestall secession by making the domestic institutions of the states inviolable, was abandoned and forgotten during the four years of Civil War. Thus, for sixty-four years no amendment proposed by Congress had failed of adoption and, with one exception, no such amendment had failed for one hundred and thirteen years. It might be added that no amendment enlarging the powers of the Federal Government at the expense of the states had ever failed to be carried through before.

Active Opposition

It is true that the proposed Twentieth Amendment was a far more direct and vital invasion of the reserved powers of the state governments than any that had gone before. It is also true that it was the first amendment proposed by Congress that would have vested in the Federal Government an unlimited power over any class of the population. For these reasons, it was vigorously opposed by many public spirited citizens in all walks of life, and although such organizations as the National Association of Manufacturers, the National Grange, the American Farm Bureau Federation, and others, took an active part against it, they only did a small part of the work that private citizens, constitutional leagues and other purely patriotic and disinterested bodies undertook. Among

others, the Sentinels of the Republic, an organization formed for purely public purposes and supported entirely by voluntary contributions, took a leading part. In the State of Massachusetts, whose legislature in 1924 had, by a large majority, petitioned Congress to enact such an amendment, a popular advisory referendum was held in November, 1924, upon the question of ratification. About a million votes were cast after a very thorough public discussion and the result was in favor of rejection by three to one. The legislatures of four of the New England states were very nearly unanimous against the proposal. The Sentinels of the Republic had a large share in presenting the arguments to the people of New England, both through the press and on the platform. Nor did they confine their activities to New England. At a largely attended public meeting in Philadelphia in December, 1924, they carried the campaign against such an extension of the Federal power into a state which had, ever since the Civil War, supported the doctrine of centralization. At this time Pennsylvania was almost as emphatic as New England and the South in rejecting the proposed grant.

Among the arguments used in the course of this campaign appeared from time to time the statement that the amendment would authorize the nationalization of children, and its advocates were accused of seeking to introduce the principles of bolshevism. The opponents of the amendment were roundly denounced for making this accusation. Many responsible persons, however, were not afraid to repeat it. They took the position, not that the majority of the amendment advocates were communists at heart, but that they were misled into supporting a measure whose legal effect would be the introduction into the American Constitution of a distinctly communist principle. The principle that the child is a ward of the state, and that it is legal for the state to supersede the parents and direct the child, up to the age of eighteen, whether he shall work at all, at any occupation, and thus control his livelihood, irrespective of considerations of public health, safety and morals, is one that has hitherto been excluded from American soil. The power to be conferred by the amendment of prohibiting any and all labor up to eighteen might never be used to its full extent, but the mere granting of such power would radically alter the relation of the citizen to the government. If the existence of such arbitrary authority over the very lives of young people should once be conceded, what sanctity could be claimed for the personal liberties or the property of any class of the population? The Supreme Court has well said: "The theory of our governments, state and national, is opposed to the deposit of unlimited power anywhere."[1] This amendment by its terms would vest in Congress unlimited power to enforce a state of idleness upon all or any part of the population that had not reached the age of eighteen. By necessary implication, of course, Congress could go further and provide for the support and maintenance of the idle youth, and possibly could regulate their education and their recreation by way of enforcing a total prohibition of productive labor, whether such labor be at home, on the farm, in the factory or elsewhere.

There is no question, of course, as to the authority of the several states to regulate the conditions of the employment of minors, and even of women, with regard to their effect on the health, morals and safety of the population.

[1] (*Loan Asso.* v. *Topeka*, 20 Wall. 663.)

The prohibition of work in factories and elsewhere of immature children and the requirement that they shall attend school for a reasonable time, are recognized portions of the police power reserved by the states. All such legislation has to bear the test of the rule of reason implied in the guaranty of life, liberty and property against arbitrary action by either the states or the Federal Government. But the express terms of this amendment authorize the prohibition of all work without any regard to the rule of reason, and, consequently, without the possibility of a review in the courts and the striking down of any unreasonable invasion of the most sacred right of any free man, that is to say, his right to work for his livelihood or for the support of those near and dear to him. If the Constitution of the United States should no longer guarantee this right, it is hard to see how its guaranties of the rights of property and contract could for long be sustained against the legislative power.

A FALLEN IDOL

This, which was probably the most fundamental ground of objection to the proposed amendment, was doubtless only partly appreciated by the bulk of the amendment's opponents. The objection to increasing the powers of the Federal bureaucracy and the further stripping of the state and local governments of their proper responsibilities, formed, perhaps, the more obvious and indeed all sufficient reasons for the rejection of the measure. This indicates a profound change in the attitude of the public. A very few years ago the response of the average man to any criticism of local administration of the law was to apply to the Federal Government to take charge. Federal efficiency was everywhere contrasted in the public mind with state and local inefficiency. The Federal courts in criminal cases convicted a far larger proportion of criminals tried before them than did most state courts. In civil cases their judgments were looked up to with higher respect. The administrative officers of the government seemed in general unapproachable, efficient and, one might say, relentless in performing their duties. Now, this impression has largely vanished. Not only the great object lesson of the failure on the part of the Federal Government to enforce the prohibition law, even to a reasonable extent, in the great centers of population, but their extraordinary inability for long periods of time to check smuggling, and to enforce the restraints on immigration, the break-down of the policy of curbing trusts and monopolies, the frequent exhibitions of inefficiency in such long established and peculiarly proper Federal functions as the Post Office, the Navy, the Army, the public lands, and last, but not least, in the administration of the income tax with its aggravating burden of "red tape" and delays—all these experiences have produced in the average citizen a revulsion of feeling. No longer does he think that Washington is the center of efficient government. He sees the Federal courts congested with petty cases and the wheels of justice refusing to revolve. He sees settlement of his personal affairs delayed for years, while the intimate details of his business are bandied to and fro between the desks of officialdom. He sees the bootlegger thrive and partakes liberally of his products. He reads that even foreigners coming to our shores are subjected, without apparent reason, to nameless indignities at Ellis Island.

On the other hand, he knows that he has not the same trouble with the authorities in his own city and state. Justice is administered far better in

some states than in others, but in few is it subject to the delays and technicalities that hamper litigation in the Federal courts. His liberties are but slightly interfered with by his home government, and if the settlement of an estate entails complications, he finds the officials not only accessible, but willing to take those reasonable short cuts that the Federal bureaucracy never takes, except occasionally for sinister reasons, but without which neither public nor private business can ever get ahead.

DANGERS OF CENTRALIZATION

The American public in short is waking up to the fact that a centralized bureaucracy is an inefficient form of government. It was not the injustice or cruelty of the government of the Czars that produced the Russian Revolution. It was its frightful inefficiency in the face of grave emergency. The theoretical advantages of popular government would never have enabled the liberal forces which brought about the fall of the autocracy to accomplish their purpose if the people and the army had not been entirely alienated by a government that was sending its troops into battle without rifles, guns or ammunition. In the smaller European nations, centralized bureaucracy, in order to survive, is compelled to attach itself to despotic power, as in Italy and Spain. Russia, after its first brief experiment, has been compelled to revert to this Asiatic type of government. Democracy and bureaucracy are fundamentally incompatible, because bureaucracy cannot by its nature respond to popular needs and democracy is incapable of controlling its operations.

The truth seems to be that modern civilization is so infinitely complex that its regulation from above is beyond the controlling power of any group or organization of men. A dictator, it is true, may impose his will on a nation for a certain length of time and steer it in a certain direction. The error of his course may be all the greater because it is not apparent to contemporary critics. Peter the Great some two or three hundred years ago created the Russian Empire and for a long time his handiwork might be pointed to as proof of his statesmanship. But the greatest contribution of Russia to world history is probably the demonstration of the danger that exists in creating such massive governmental structures whose inevitable fall brings about the most irreparable ruin.

It is hard to say whether the framers of the American Constitution or any of them were conscious of the ultimate dangers inherent in the concentration of power. As individuals they were chiefly concerned with the preservation of the individual liberties of themselves and their children. They formed a government decentralized for peace, but holding concentrated power for war. The forces of concentration have appeared at times immensely strong and it has seemed that our whole system was gravitating towards imperialism as by an invincible attraction. It has seemed to some that the rejection of the proposed Twentieth Amendment was a case of halting on the brink of the precipice. But there have been other occasions when the same halt has been made. The Fourteenth Amendment was no doubt intended by its promoters to produce a complete concentration of legislative power in Congress. They found it necessary, however, in order to accomplish this, to load it down with purely political clauses that appealed at that time to the dominant majority. They carried it with the help of these clauses in spite of its ulterior purpose which was largely concealed from the people. The Supreme Court in con-

struing it later by a five to four decision, adopted the probable views of the people whose representatives ratified the Amendment instead of the secret hopes of its draftsmen and promoters.[2] So construed it became a mere prohibition against the states from denying the individual liberties that their governments had been created to protect, and it has operated to vest no important powers in Congress other than those which that body had always enjoyed.

POPULAR OPPOSITION

At the present time the tendency towards centralization has not been resisted merely by a five to four decision by the Supreme Court, although in the first child labor case[3] a five to four decision did prevent the extension of bureaucratic power over this subject, through a perversion of the commerce clause. But the fundamental issue, whether to vest plenary power in Congress over the intimate domestic relations of the people, has been answered in the negative by an amazing popular majority, not confined to any state or section of the Union. While it is true that in Massachusetts alone the question was directly submitted to the voters, yet every legislature that rejected the Amendment, with one or possibly two exceptions, was elected after its proposal and when the matter was being debated by the public. The legislative majorities in favor of rejection were in almost all cases enormous, showing a tremendous weight of popular opposition to the project. It is a striking commentary on the aloofness of Washington from the currents of popular feeling that this repudiation of their work came as a complete surprise to the Congress which had by a large majority in spite of vehement protests submitted the proposal. It must be taken to indicate that the scheme of local self-government upon which the Constitution is based is one that at heart still appeals to the people of all of the United States. Even one of the four ratifying states—Arkansas, which ratified before the election of a new legislature—after further consideration, sought to recall its act, and if the result had then been in doubt, would probably have proceeded to test its disputed right to do so.

The contest between federalism and imperialism, or local self-government and centralization, will, of course, continue. But it is refreshing to believers in the principles of Anglo-Saxon liberalism to find that after one hundred and thirty-six years of experience, the people of the United States of America are still unwilling to adopt a scheme essentially foreign to all their antecedents. Like the English barons who, when pressed at the field of Merton to adopt the law of Rome in place of their own, clashed their shields and shouted, "*Nolumus leges Angliae mutare*," the legislatures of the sovereign states of the Union have in the year 1926 given the same reply.

[2] Slaughter House cases, 16 Wall., 36.
[3] *Hammer* v. *Degenhardt*, 247 U. S. 251.

What the National Child Labor Committee Is Doing at the Present Time

By WILEY H. SWIFT
Acting General Secretary, National Child Labor Committee

I HAVE been requested to tell something of what the National Child Labor Committee is doing at the present time and this I gladly do. The fact that I shall not discuss child labor and the Federal Government should not be taken to indicate any opposition on the part of the National Child Labor Committee to the Child Labor Amendment. It believes in the principle and in the form as adopted by Congress, and also in the social value of co-operation between the state and the nation not only in matters relating to the employment of children, but also in other matters. It believes that the nation should be in position to give full protection to every child from harmful employment whenever the family, the community, the country and the state all fail.

The Committee, seeking to insure reasonable protection from harmful and therefore wrongful employment by whatever legitimate means possible, concerns itself far less with the means than with the end. Full protection for every child could be provided by state legislation. The people in failing to ratify the Amendment, we feel sure, had no intention of expressing disapproval of all child labor regulation, but they did indicate a very decided preference to travel the state road to the goal and the Committee is ready, as it has always been, to travel with them.

Time does not wait and the tendency is for some children to enter industry as soon as the law permits. The law of any state, even where poorly enforced, undoubtedly serves as a standard by which most people govern themselves. For the sake of those children who are now employed, or who may be employed within the next four, six or eight years or more, the Committee feels that it should devote its attention to the matter of improving conditions and of preventing harmful employment by reasonably good state laws adequately enforced.

No sane person in this country desires or is willing to do any injustice to any child. Whatever harm is being done to children or society by improper child employment comes as a result, if not of ignorance then at least of a failure to understand the cost of child labor on the one hand, and proper standards on the other. The people must have some standard by which to measure themselves.

The legislatures of more than forty states will meet in 1927. The child labor laws of most of them should be improved in one or more respects, and it is practically certain that the subject will be given some consideration in every one of these states. Realizing all this, the National Child Labor Committee after very careful study has prepared and distributed as widely as possible a statement of Minimum Standards as follows:

MINIMUM STANDARDS

I. No child under fourteen to be employed at any gainful occupation.

II. No child under sixteen to be employed:

1. At any work or in any place dangerous, injurious or hazard-

ous. Places and occupations known to be dangerous, injurious or hazardous for children under sixteen should be enumerated in the law, but authority should be delegated to some state board to extend the list.

2. After seven at night or before six in the morning.
3. For more than eight hours a day, or six days or forty-eight hours a week.
4. During the hours when the public school is in session unless the child has completed the eighth grade or its equivalent.
5. Unless the employer gets a work permit from the proper school official upon the following four conditions: (Except that no work permit is to be required for work in domestic service or agriculture).
   (a) A promise of employment showing the exact nature of the work.
   (b) Evidence that the child is of legal age for that specific employment.
   (c) Evidence that the child has completed the eighth grade of the public school or its equivalent. If all other requirements are complied with, this should be waived during the time the public school is not in session, a special vacation work permit being issued.
   (d) A statement by an authorized physician showing that he finds the child physically fit for that particular employment.

III. No child under eighteen to be employed at any work or in any place dangerous, injurious or hazardous for children under eighteen. Places and occupations known to be dangerous, injurious or hazardous for children under eighteen should be enumerated in the law, but authority should be delegated to some state board to extend the list.

The National Child Labor Committee hopes that by the time the Federal Amendment is ratified by thirty-six states, if it is, these standards will have become so well fixed not only in the body of the law of every state, but in the mind of every thinking citizen and as a part of the community custom, that when the Federal Amendment is ratified there will not be nearly the necessity for thinking about Minimum Standards as at present.

Suppose a farmer has a meadow ready to cut and can't get a mowing machine. What is he to do? Wait around fussing with his neighbors because none of them will lend him a machine until the grass is ruined? Not at all, if he is wise. He gets himself a good scythe and wades in. A good man can cut a stack of hay any day and a stack of hay is not to be grinned at when the wind blows in January.

The illustration makes clear the policy of the Committee.

Whether the Federal Child Labor Amendment is or is not to be ratified, is of course a matter for the people to decide. While they are deciding, or even if they should decide not to ratify, the wise course it seems to us would be for the different states so to improve their laws regulating the employment of children that no child in the whole country would live without protection from exploitation by law. State law if it does the job is as good as any other law. In fact, it may be said that the most ardent advocates of the Federal Child Labor Amendment have from the first clearly understood that most of the job should be done by the states, and in pressing for the Federal Amendment we have only sought a way by which helpful co-operation could be established between the nation and the different states.

The State, the Nation and the People's Needs[1]

By Hon. Gifford Pinchot
Governor of the Commonwealth of Pennsylvania

THERE has been much discussion of late as to what taxes may properly be collected and what expenditures may properly be made by the state and Federal governments respectively. This is so basic a matter that the view adopted concerning it necessarily controls not only in financial affairs but in the whole scheme of our institutions. In particular it must influence the answer we make to the vital question: By whom shall our governments be dominated, and for whose benefit shall they be conducted?

Under the Federal Constitution the state and Federal governments are friendly allies, not opposing interests, in spite of much talk to the contrary. Let me recall that in an address delivered at the dedication of the present State Capitol of Pennsylvania in 1906, Roosevelt quoted with approval a letter of James Wilson, a great Pennsylvanian, signer of the Declaration of Independence, maker of the Federal Constitution, and Associate Justice of the Supreme Court of the United States, and said:

> He (Wilson) laid down the proposition that it should be made clear that there were neither vacancies nor interferences between the limits of State and National jurisdiction; and that both jurisdictions together composed only one uniform and comprehensive system of government and laws; that is, whenever the States cannot act, because the need to be met is not one of merely a single locality, then the National Government, representing all the people, should have complete power to act. It was in the spirit of Wilson that Washington, and Washington's lieutenant, Hamilton, acted; and it was in the same spirit that Marshall construed the law.

Chief Justice Marshall pointed out the danger of the opposite view with admirable clearness.

> Powerful and ingenious minds, said he, taking, as postulates, that the powers expressly granted to the government of the Union, are to be contracted, by construction, into the narrowest possible compass, and that the original powers of the States are retained, if any possible construction will retain them, may, by a course of well digested, but refined and metaphysical reasoning, founded on these premises, explain away the Constitution of our country, and leave it a magnificent structure indeed to look at, but totally unfit for use.

Need for State and Federal Co-operation

I have small sympathy with the view which regards every new use of the Federal power as necessarily a usurpation of rights properly belonging to the states. The recent outburst against President Coolidge's order for the co-operative use of state and local officials in law enforcement is a typical example. Federal and state action should be co-operative, and not hostile. This principle of Federal and state co-operation we have applied in the Pennsylvania Water Power Act of 1923, which alone among the laws of all the states, so far as I know, co-ordinates Federal and state authority over water power development into a harmonious and complete whole.

[1] This is in part an address given by Governor Pinchot at the Governors' Conference held in Cheyenne, Wyoming, July 26, 1926.
— The Editor.

I deprecate the tendency to attack in a spirit of hostility the Federal Government for what it is properly doing for the people of the individual states. At the same time I insist that, as Roosevelt said, "the several States must do their duty or our citizenship can never be put on a proper plane."

THE EXERCISE OF FEDERAL POWER

But I recognize the fact that modern progress in America depends upon, and is inseparably bound up with, an increasing exercise of Federal power. This is true not only because modern means of communication—the railroad, the transcontinental telegraph and telephone, the motor car, the aeroplane, and the radio—must continue to result in a constantly closer national unity, but also because the problems before our people are in constantly increasing measure national problems beyond the powers of the states to solve.

The exercise of Federal power is growing and will continue to grow. It is growing not only because that growth is a necessity of our national existence, not only because we cannot otherwise protect the people against oppression by huge concentrations of wealth, but also because governmental units less than the Nation continually fail to do the things the people need; and the Nation itself is therefore obliged to make their failure good.

If the people need action and a township fails to supply it, the county naturally steps in; if the county fails, the state steps in; if the state fails, the Nation steps in. Many things are being done to-day by the Nation simply because the states, for whatever reason, have failed to give the people what they properly require.

Because the public utility corporations of Pennsylvania thirteen years ago, and again in 1925 and 1926, defeated legislation to give the State Public Service Commission control over security issues, I was compelled this year to ask the Federal Power Commission to control the security issues for financing the Conowingo Hydro Electric Project now being constructed on the Susquehanna River under Federal license. The Nation stepped in, and the people were protected after all.

In guaranteeing the movement across state boundaries of men, goods and information, unfettered by state restrictions, the Federal Constitution contributed the greatest man-made element to the economic well-being of the people of all the states. This it was that opened to American skill and American energy, armed with the equipment that we call capital, the greatest economic opportunity that mankind has ever had.

This guaranty gave to American business its unmatched opportunity for expansion over half a continent. It also made impossible any generally effective state control of that expanded business, and by so doing made necessary the exercise of Federal control. The present outcry for state rights for the most part ignores this fundamental necessity.

A state is no longer, if it ever was at all, a natural economic unit. The great public services which supply transportation, light, heat and power; the huge corporations which make, prepare, and sell steel, oil and coal to the citizens of a single commonwealth, are no longer confined within its boundaries. Their enormous resources in wealth, in political and social influence, and in legal ability are confined by no state lines and make the individual states in most cases, if not in all, helpless before them; and no one knows that better than the great monopolies themselves.

To illustrate, the outstanding barrier

to effective state control over telephone service by companies operating within the several states is the American Telephone and Telegraph Company. The problem of regulating it is the despair of all state utility commissions. The same difficulty inheres in every utility holding company which controls operating companies in two or more states.

Again, there is no better example of how a problem breaks across state and regional lines in an emergency than in the present agricultural situation. No practical man believes that the problem, for example, of wheat production and distribution, or of corn, can be confined to any individual state or solved by any individual state. It is a national question, and can be nothing else.

LAW ENFORCEMENT

There are to-day, three outstanding problems before the Nation—one mainly moral and two mainly economic. The moral problem—the greatest we have—is that of law enforcement. In dealing with that there must be no twilight zone between state and Federal authority where the enemies of society may hide themselves and escape punishment. Neither can we suffer the state-made nullification of our National Constitution, whether under the guise of a state referendum or by the failure of the state to exercise its co-ordinate powers. State and Nation both are needed in this fight for the Constitution, for self-government, and for national self-respect. All the power there is is not too much to exercise against the alcohol criminals.

An admirable example of the failure to co-operate from which criminals profit was the order of Secretary Mellon, in reply to my request for permission to the State Police to inspect breweries under Federal permit, in which he allowed them to enter the breweries during business hours only, it being, of course, well known that crimes are always committed during business hours and never after closing time.

CONTROL OF MONOPOLIES

Two great economic problems look our people squarely in the face. One is the conservation and wise use of our natural resources, so as to perpetuate our national life. The other is the control of great nation-wide corporate monopolies, so as to perpetuate our national institutions. Of this control Roosevelt said:

> But it is our clear duty to see, in the interest of the people, that there is adequate supervision and control over the business use of the swollen fortunes of today. . . . Only the Nation can do this work. To relegate it to the States is a farce, and is simply another way of saying that it shall not be done at all.

It should never be forgotten for a moment how much of the agitation against the use of Federal powers for the protection of the people comes originally from the great monopolistic corporations and their allies. They are against Federal control where Federal control can be effective. But they are equally against State control where State control can be effective. What they are really against is any effective control by whomsoever exercised. The one principle from which they never depart is opposition to any exercise of power by the people to prevent the corporations from dealing with the people solely in the interests of the corporations.

I do not speak of this matter from hearsay. I have served both the Nation and my own state, and in both capacities I have seen great monopolies using their resources to the limit to prevent the exercise of whichever power had undertaken in any case to regulate

them efficiently in the public interest. By definite practical contact, extending over more than a quarter of a century, I have learned the utter futility of attempting to regulate interstate corporations by the action of a single state. Experience, which is the best of all teachers, has convinced me for good and all that nation-wide evils must be met by nation-wide remedies.

I am a loyal Pennsylvanian, but I am an American first. My state is the Keystone State, and the Nation has never called upon it in vain in any crisis. There is no more powerful commonwealth in America, but for all that I cannot shut my eyes to the essential fact that the steel trust, the oil trust, and greatest and most formidable of all, the growing electric trust, cannot be adequately dealt with for the protection of Pennsylvanians by Pennsylvania alone.

This is not to say that the state governments are not of high and increasing importance. Like the Federal Government, they are steadily attracting to themselves new functions. They are taking over from local governments important duties in highway construction and maintenance, in school financing and standardization, and in safeguarding the public health. To these they are adding new functions hitherto unperformed by any government, such as forest and water conservation, control of labor conditions, assistance to agriculture, and others.

These functions cannot be fulfilled as the public welfare requires unless a state government is efficiently organized, soundly financed, and economically administered in the interest of the whole people of the state.

There has been much talk against Federal appropriations to states on a fifty-fifty basis for the protection of forests, the building of roads, the safeguarding of childhood and the assistance of the farmer. Some of these protests come from my own state. They are based on the narrow and unworthy theory that each state exists for itself alone; that national taxes raised in Pennsylvania or in New York must never be expended by the Federal Government outside the states in which they are collected; and generally on the idea that we are not a nation but a mere agglomeration of independent communities each mainly anxious to get or keep everything it can at the expense of its neighbors.

This attitude of petty selfishness is widely and sometimes successfully employed as an appeal to local prejudice by the servants of monopolistic corporations in Congress whose actual purpose is certainly not the advantage of the plain people whom at the time they happen officially to represent.

Federal taxes raised in New York or in Pennsylvania are not alone the result of industries or activities in those states, but necessarily include the product of natural resources or industrial enterprises in other states. I have yet to be convinced that the expenditure of the Nation in the construction, for example, of the Salt River Reclamation Project in Arizona or in the improvement of New York Harbor is adding solely and only to the prosperity of the localities in which the actual work is done.

CONSERVATION OF NATURAL RESOURCES

My own experience in forestry and in the conservation of other public resources confirms strongly the theory that the Federal Government has worked generally for the interest of the average man. The charge made years ago that Wyoming and the other western states would suffer because of the support of the strong arm of Federal co-operation in forestry, irrigation, etc.,

has fallen flat. To-day the prosperity and wide improvement of the West, and the attitude of its people, supply the conclusive answer.

For over one hundred years a national system of highways has been the dream of American statesmen. Now that dream is being realized, and realized largely because the Federal Government is assisting the several states by spending money for highway construction in co-operation with them. And if some Federal money raised in Pennsylvania should be spent in promoting the prosperity and purchasing power of other states, it is bread upon the waters, for the industries of Pennsylvania will find that their bread will return to them even after many days.

I have yet to find reason for believing that the Golden Rule is less applicable to states than it is to individuals. Therefore Pennsylvania is protecting from pollution within her borders the public water supplies of the State of Maryland, and this just as carefully as she protects those of her own cities.

There are also regional questions which do not include the whole Nation, and which can best be handled by the means provided in the Federal Constitution of compacts between groups of states.

Last year Pennsylvania sought control by this method of electric holding companies doing business in a number of states, and electric operating companies doing interstate transmission. We were baffled by the extreme State Rights doctrinaires of a neighboring state. The result is that the process of combination in the electric business is going on by giant strides without due regulation by any authority, Federal, regional, or state. It is a perfect example of how mutual jealousies between state and Nation benefit none but those who would escape the power of both.

Roosevelt described himself as a strong Nationalist, and believed in the necessity for increasing the power of the Federal Government. So am and so do I.

If, said he, we fail thus to increase it, we show our impotence and leave ourselves at the mercy of those ingenious legal advisers of the holders of vast corporate wealth who . . . are ceaselessly on the watch to cry out that the Constitution is violated whenever any effort is made to invoke the aid of the National Government. . . . The doctrine they preach would make the Constitution merely the shield of incompetence and the excuse for governmental paralysis. They treat it as the justification for refusing to attempt the remedy of evil, instead of as the source of vital power necessary for the existence of a mighty and ever growing Nation.

Prohibition Enforcement as a Phase of Federal Versus State Jurisdiction in American Life

By Hon. Lincoln C. Andrews
Assistant Secretary of the Treasury, in charge of Prohibition

LOOKING into our Federal Constitution, adopted to make our government "a more perfect union," we find three pertinent facts of immediate interest to my subject: First, that Congress was given the power "to regulate commerce with foreign nations and among the several states"; second, that the police power—the power to legislate for the promotion of the safety, health, morals and general welfare of the people—was reserved to the several states; and third, that property rights were safeguarded by the "due process" provision. The exercise of these two sovereign powers, and the appeal to this constitutional safeguard, had an early and continuing influence on the fortunes of the liquor question—marking the various historical steps, legislative and judicial, in the evolution of National Prohibition.

State and Federal Bickerings

Congress had laid imposts on liquors imported from a foreign country, and in 1827 the United States Supreme Court decided that the state could not interfere with such liquors until they had lost their "foreign commerce" character. Thus the commerce power of the Federal Government first appeared as a serious check on the exercise of the police power by the states.

In 1847 the question arose as to liquors in interstate commerce, and the Supreme Court held that in a matter of general interest a state could legislate in regard to interstate commerce until Congress stepped in to exercise its power in the same field. Thus the courts in 1827 checked state control of international liquor, and in 1847 allowed state control great power in interstate liquor.

In 1887 the see-saw started back again, when the Supreme Court laid down the doctrine that while a state might, under its police power, prohibit the manufacture and sale of intoxicants within its borders, nevertheless intoxicating liquor was a legitimate subject of interstate commerce, and that the state could not interfere with such commerce by prohibitive legislation; nor, since sale is an essential part of commerce, could it prohibit sale in the original package.

Close on this decision, in 1890, the Supreme Court renounced the previous doctrine that the states could legislate where Congress had failed to act. So we find the state denied the power to prohibit the introduction of liquor from other states, and to prevent its sale in the package in which introduced. Under these decisions, both foreign and interstate liquor marched joyfully where it would, immune from state police power while in original packages, and the most stringent state regulations were powerless to thwart it.

In addition to these disabilities, the "due process" clause of the Constitution was proving a serious check on the state's power to regulate intrastate liquors. The view prevailed that, although a state could prohibit, under its police power, that which adversely affected the public health, morals, safety or general welfare, the mere possession of liquors did not fall

in this class, and consequently the police power could not be invoked to prohibit possession.

Of course these constitutional barriers later fell one by one as the cohorts of prohibition advanced, until the Supreme Court in 1918 held it constitutional for a state, under its police power, to make the possession of whiskey for personal use a criminal offense. Later it went so far as to say that the fact that such a statute destroyed property rights lawfully acquired in the liquor before the law became effective, did not constitute a violation of the constitutional mandate against taking property without due process of law. But this came later, and it may be said in general that in 1890 the states could constitutionally prohibit only the manufacture and sale of intoxicating liquors. It is interesting to note that during these years the Federal Government took no steps looking to direct Federal control of liquors through the exercise of its interstate commerce power, as it ultimately did in the matters of oleomargarine, white slavery, Louisiana Lottery, etc.

Thus we find the states,—because of Federal inhibitions, unable to cope effectively with liquor, either domestic or imported; and we find Congress unwilling to deal with it independently from the states. But we also find an insistent and ever-growing sentiment throughout the country against the traffic in intoxicating liquors. Consequently the Federal legislative development was along the lines of Federal co-operation in assistance of the states that wished to be dry.

Owing to the immunity afforded the original packages of liquor brought into the dry states from outside, these states found themselves overrun with "original package shops," and had to seek Federal aid in order to combat them. Congress felt that its sovereign commerce power should not remain a means of defeating the dry policy of a state, and passed the Wilson Act in 1890, which removed from imported liquors their character of "interstate" or "foreign" goods, upon their "arrival" within the state. This was intended to allow the state to prevent the sale of the imported "original packages." But the Supreme Court largely destroyed the value of this act, by construing arrival to mean "commercial" arrival—delivery to the consignee, not physical arrival within the borders. Delivery to the package shops for sale could be prevented, but delivery to a consignee for use could not. The shops were thus cleaned up, but any citizen could still receive all the liquor he chose to order. The state remained powerless to repress importation for personal consumption, and was deluged by liquors thus obtained.

Congress spent twenty odd years suggesting remedies for the shortcomings of the Wilson Act. There seemed to be constitutional objections to all of them, and nothing was done until 1913. Meanwhile the states in desperation strengthened their laws as they could, and began to limit the amount of liquor that a man could possess.

In 1913 Congress passed the Webb-Kenyon Act, which removed the protection of the commerce clause from any liquor intended to be received, sold or used in violation of the laws of the state to which it was sent; and subjected such liquors entirely to the control of the offended state. Both the Wilson Act and the Webb-Kenyon Act were attacked in the courts as unconstitutional, as attempts to delegate to the states a control of interstate commerce. President Taft, in his veto message, expressed doubt as to the constitutionality of the Webb-Kenyon

Act. The Supreme Court sustained both acts. It declared that Congress was dealing with a commodity, the transportation of which it might prohibit entirely, and which the states on the other hand were powerless to prevent being brought within their borders. Instead of prohibiting the liquor traffic entirely, Congress chose to take from it the protection of the commerce clause, and to leave it to be dealt with wholly by the communities whose problem it was. Thus in 1913 we find the Federal Government, judicial and legislative, positively in co-operation with the states—stepping out of the way and allowing the states to control both domestic and interstate liquors within their own borders.

MOVE TOWARD NATIONAL PROHIBITION

From 1913 to '18 events moved fast. In the end Congress abandoned its policy of assisting the states, and turned to that direct Federal control which it had theretofore eschewed. The desire for nation-wide prohibition had grown from an idealistic sigh to a positive demand. In 1913 the Anti-Saloon League launched its organized campaign for national prohibition. Between the years of 1914 and 1918, twenty-three states sounded out the sentiment of their people by the referendum. At the time prohibition became effective thirty-three states were dry. A resolution calling for a prohibition amendment to the Constitution was introduced into both Houses in 1913 and failed to pass in 1914. Similar resolutions were introduced in 1915, but not brought to a vote in either House.

But before this same Congress Senator Jones propounded his view that the states needed still further Federal assistance. Believing that the states were still powerless to combat "solicitations of orders for liquors" coming through the United States mails, he proposed an amendment to a post-office measure penalizing the mailing of solicitations into a state which had prohibited them. He was still working on the theory of Congressional co-operation with the states.

In discussing the Jones amendment, Senator Reed pointed out the inconsistency of fixing penalties for the mailing of solicitations into a state which forbade solicitations, while tolerating the shipping of the liquor itself into a state which forbade liquor. So the Senate in 1917 passed the Jones amendment, and at the same time passed Senator Reed's amendment—the Reed Bone-Dry Law—making it a Federal offense "to order, purchase or cause intoxicating liquors to be transported" into any state that prohibited the manufacture and sale thereof. Thus we see a complete about face on the part of Congress, and we see in Senator Reed of Missouri the father of the first national prohibition liquor law. It is also interesting to note that this law was passed by a Congress which had chosen not to bring to a vote a proposition for National Prohibition.

The Reed Law made the dry state bone-dry whether the state liked it or not. In fact it was suggested in debate on the Reed Law that it was proposed in order to so vex a dry state with its dry law that other states would hesitate to go dry. It did in fact make one state dryer than it intended to be. West Virginia prohibited the manufacture and sale of liquor, but permitted a parched citizen to bring into the state a quart of liquor every thirty days for his personal use. One fellow was caught while doing this, and tried in the Federal court under the Reed Law. The Supreme Court held in 1919 that he was guilty of a Federal offense, that the Reed Law was constitutional,

and that any oasis in a state law that conflicted with it was invalid. West Virginia was suddenly bone-dry by Federal command. The only way she could allow her citizens to bring in their quart was to repeal her prohibition against the manufacture and sale of liquor—and it has been hinted that the liquor interests liked the Reed Law for just this reason.

THE 18TH AMENDMENT

The 64th Congress had declined National Prohibition and passed the Reed amendment. The 65th Congress passed the National Prohibition resolution. It was adopted by the Senate on August 1, 1917, without the provision for a concurrent power of enforcement in both the Congress and the states. Congress alone was given the power to enforce the proposed amendment by appropriate legislation. Dropping all consideration of state police power, the Senate went to the extreme of absolute Federal responsibility and control through the exercise of a thus to be acquired Federal police power, to be exercised throughout the states and communities of the land. This easily accepted conception of employing a highly centralized governmental police power, and this seeming disregard for our long cherished doctrine of states rights, would appear to be marked evidence of a wartime state of mind on the part of the Senate, when acting upon this resolution.

The debate on the resolution is interesting. The opponents of the resolution were against taking from the states their control of their local affairs and giving it to Congress. They felt that Federal co-operation had made it possible for any state to be as dry as it wanted to be, and that the minority of the states should not be forced to go dry because of the social views of the majority. The proponents of the resolution maintained that Federal co-operation had proved ineffective in aiding the dry states to become dry. Wet neighbors were too damaging an influence, even with full state and Federal co-operation. They maintained that since a dry state could not establish complete prohibition as a state, it had a right to urge National Prohibition; not primarily to stuff its views down the throat of a wet state, but for its own protection. They pointed out that while it might be a questionable policy for thirty-six states to impose their social standard upon twelve states, it was true that otherwise the thirty-six states could not protect themselves against the twelve states.

The House amended the resolution to read as the amendment now does—Congress and the several states being given concurrent power to enforce the amendment by appropriate legislation. It was stated by members of the judiciary committee instrumental in inserting this concurrent phrase—notably Mr. Webb and Mr. Volstead—that this phrase had been put in to make it plain that there was reserved to the states their power to enforce their prohibition laws; and that the granting of a like power to Congress should not have the effect of granting all such power exclusively to Congress. There was surprisingly little debate in the House as to the meaning of "concurrent" in the resolution. Both Houses seemed more interested in the giving of a new power to Congress than in the reserving of its old power to the states. They argued the question chiefly on principle, and did not pay much attention to the problem of how Federal and state control of liquors would work out in practice under the concurrent clause.

EFFECT OF THE AMENDMENT

Reading the record, it is my opinion that Congress as a whole had little

conception of the practical difficulties of the enforcement of the amendment. The concurrent clause was inserted more as a concession to the psychology of the states than with the purpose of requiring the states to function in those fields of enforcement where the state police power rather than the Federal mandate would be not only more effective, but more consonant with our form of government.

The language of section 2 of the 18th Amendment is: "The Congress and the several states shall have concurrent power to enforce this article by appropriate legislation." What does it mean? The Supreme Court says that it does not mean "joint" power. The view that "concurrent" means that the power to enact appropriate enforcing legislation is in each—the state and the Federal—but that the legislation of Congress as the supreme law of the land supersedes any inconsistent state legislation has received some support from the courts. Support has also been given the view that the power is equally in each—the state and the Federal—neither having any over-riding force as to the other because each is effective in its own jurisdiction and the validity of each is to be tested only by the touchstone of appropriateness to the enforcement of the 18th Amendment. On one point, however, courts are uniform with one or two exceptions;—the 18th Amendment is *not* the *source* of the state's power to legislate with regard to intoxicating liquors, but the source of such power is still its police power, which inheres in it as a sovereignty. The 18th Amendment reserved to the state its police power over this question; it did not give it such power.

The effect of the 18th Amendment was to reserve to the states this police power in its entirety with the one limitation that the states were put under a legal disability to permit what the 18th Amendment prohibited. It even enlarges the state's power beyond the limits of its other police powers, since on other questions state laws are subject to constitutional inhibitions as regards "due process," interstate commerce, etc. In addition, the 18th Amendment by its terms gave to the states an authority concurrent with Congress over the importation and exportation of intoxicating liquors; and over liquors in interstate commerce, by the rule of constitutional construction which renders paramount an amendment subsequent in time to a prior constitutional provision which conflicts with it. The state gained much, and lost only the privilege and power to permit the manufacture, sale and transportation of intoxicating beverages. Congress acquired the police power, the several states retained theirs. The former policy of assisting the states by removing constitutional barriers to the operation of their police powers, was superseded by a plan for active co-operation in which each party has equal responsibility and power. This was a novel scheme in our government, ready to meet the test of experience.

THE COUNTRY'S REACTION

Let us see how the congressional plan worked, and is working. All the states except Maryland fell in line, and where necessary enacted appropriate legislation. The stage was auspiciously set for splendid action. But an unexpected psychology resulted in the withdrawal of most of the old skilled actors of this great drama, and left the stage largely to amateurs and a few monologists. We find co-operation on the statute books, but not carried out into the life of the community. A very curious picture. Here we had forty-seven of our forty-eight states with

state prohibition laws and the machinery to make them sting. We had the Federal Government with a prohibition law. Now the Federal Government is a new actor on this stage—a new prima donna. The states are old troupers in enforcing all police power regulations, including this one, and they know the twists and turns. They get a hand from their audience—a helping as well as an applauding hand. They are the local stock company—so to speak—known to the folks. The new prima donna has not appeared on this stage before, having been only a supernumerary. When the curtain goes up, the company stays in the dressing rooms, make-up on, rôles perfected, and expects the new prima donna to play all rôles, including that of the villain. A very curious reaction, this attitude of the people, after they got National Prohibition.

The great forces of social reform that had worked so successfully for temperance along educational lines, instead of grasping this opportunity for a steady forceful advance to overwhelming success, apparently felt that their battle was already won, and ceased their organized efforts. The forces that had been so efficiently organized and led to accomplish these ends through political activities, now centered their energies upon the enforcement of the national law through Federal agencies. State, county and municipal law officers tended to overlook their own civic responsibilities under their community laws, and to pass the responsibility for prohibition law enforcement to the Federal law and its agents. The citizens of the country generally, thoughtlessly, and thus inconsistently with their inherent conceptions of the functions of government, tacitly and perhaps unconsciously relieved their own civic officers from their responsibilities, and looked to the national law in Federal hands for the enforcement of prohibition. Everybody looked to Washington, and placed the responsibility for law enforcement upon the Federal Government—and unfortunately for the law's success, the Federal Government was accepting this responsibility.

When I took office last year I found the Prohibition Unit organized and functioning on this basis. Highly centralized in control and responsibility, its field forces organized without due regard to their essential correlation with the field forces of the Department of Justice, prohibition agents throughout the United States were being called upon everywhere to exercise the Federal police power in local police affairs. And these agents were accepting the responsibility and arresting these petty law violators. In many jurisdictions this resulted in overwhelming the offices of the District Attorneys and clogging the Federal judicial machinery with thousands of petty police cases, not infrequently to the disgust of the Federal Bench and the discouragement of the District Attorney. More important even than this moral effect was the consequent demoralization of all the business of the Court. Already crowded with business resulting from the ever increasing number of Federal laws to be enforced, that promptness and certainty of trial and punishment so essential to successful law enforcement became an impossibility, and was being reflected in a growing disrespect for law on the part of all law violators.

Perhaps the most interesting phase of this development, and the most potent in its unfortunate effect upon the success of the National Prohibition Law, was the fact that while the citizens generally accepted the idea that the Federal Government should be responsible for the enforcement of the law, many of them nevertheless in-

herently resented this exercise of police power on the part of the Federal agents within their own communities as affecting their own individual privileges. This can be explained as thoughtlessness. Or perhaps it was the working of guilty consciences for neglecting their own responsibilities as citizens of self-governing communities who must necessarily make and enforce their own regulations for community welfare. Be it, however, thoughtlessness, guilty conscience or outraged conception of democratic government, the reaction was personal resentment, manifested far too often by law abiding citizens, both men and women, in wilful violations of the prohibition law. And this manifestation, peculiar as it may seem, evidenced itself in previously dry states, as well as in those that had never previously accepted state prohibition.

The demand for beverage liquor was insistent and apparently quite indifferent to cost. Money and brains were quickly forthcoming to organize an illicit traffic in liquor to supply this demand wherever it prevailed, and, keeping step with modern economics, created this supply, then created further demand to keep it moving, and thus a new form of liquor business grew and throve. Definitely an outlaw business, its success was necessarily conditioned to a great extent upon the bribery of officials charged with keeping law and order—so wherever its activities reached, it left a slimy trail of crime and corruption in its wake.

In the large cities the criminal classes turned from their precarious livelihood of safe cracking, loft robberies, etc., to this much more lucrative and far less dangerous profession of bootlegging. Innumerable citizens, under the present prevailing urge for easy money, turned from lawful pursuits to engage in this lucrative business. It is even reported that farmers in certain localities are now measuring their corn crops in gallons, rather than in bushels. Meantime the criminals' traditional fear of offending the Federal authorities was rapidly turned by experience in the slowness and uncertainty of punishment to a contempt for this same Federal authority. It is this condition that we have been and are now trying to correct in our effort to "Restore Respect for Federal Law."

PRESENT LAW ENFORCEMENT

Faced with this problem of law enforcement, and with these conditions, we had to answer these questions:

"What have we got to do?"

"What have we got to do it with?"

"How shall we do it?" In determining upon our policy, organization and procedure, two fundamental considerations were governing. First, a realization of the fact that any law to be effective must be in reality an expression of a standard of living generally accepted by the members of the community affected, which means that this standard is already observed by the great majority of the community, and written into a law only that it may be enforced upon the recalcitrant few by the police and court officers of the community. Applying this consideration to our problem, it required that the agencies of social reform be induced to take up again the task of education, so that the numbers who observe the prohibition laws may be materially increased, and the numbers who must be prosecuted as violators may be materially decreased. Expressed differently, this consideration meant that the prohibition laws must be popularized—both the laws and their administration must meet with more popular approval.

The second consideration was that the responsibility for the enforcement

of the prohibition laws must be shared by Federal and local authorities. And this responsibility must be shared on clearly defined lines, so that each may have a definite objective, upon which it may concentrate its energies with a fair hope of success. Looking back into the years of struggle toward the accomplishment of prohibition, realizing how until the Reed amendment in 1917 the whole conduct of national government, both legislative and judicial, had been to show a marked sympathy with the efforts of the states to regulate the use of liquor, and to co-operate with them in a helpful way; and looking at the present anomalous and directly contrary situation in which the states now lay almost supine while the whole nation looked to the Federal Government for the success of prohibition; and realizing the inherent wrongness and unquestionable thoughtlessness of this latter attitude, it seemed the only and the natural solution that the Federal Government should undertake as its share to suppress the commercialized traffic in liquor, and thus prevent its introduction into the various communities of the country in commercial quantities, and that the states and communities should undertake as their share to suppress local violations with Federal assistance where necessary. This policy was adopted and approved by the Administration. The Federal forces are more and more concentrating their efforts upon this main objective, as the civic consciousness of the communities is again aroused to their responsibilities for self-government and Federal agents thus relieved from demands upon them for the exercise of local police power.

To me this division of responsibility seems so natural and so absolutely essential as not to require argument. It is in keeping with the growing appreciation on the part of thoughtful citizens that modern tendencies toward highly centralized authority and responsibility in Washington may lead to dangerous extremes. Consider for a moment the alternative—the Federal Government accepting the full responsibility for enforcing the national law in all the communities of the land. No one knows how many policemen would be necessary, and how many Federal police courts would be required, but the numbers certainly would be tremendous, and the political and social effects of their daily contact with the intimate affairs of the citizens of the communities might easily be most disastrous to democratic institutions. In fact, such a superimposed Federal police power is to my mind absolutely unthinkable in America, and bad enough in Russia. Such a solution is predicated upon so false a conception of our government as to offend the very fundamentals of our institutions, and I believe it could never be accepted by a thoughtful public. When his consciousness is stirred, the American citizen is still proud of his claim to the rights of self-government. This was happily illustrated last winter in the nation-wide protest against the Executive Order permitting the appointment of county police officers as Federal agents. It was considered an invasion of the citizen's sacred right to manage his own affairs through his own civil officials. It appears that this sense of civic responsibility and pride in its employment still exists, and has only to be aroused, when the communities of the land will again accept their responsibilities for law enforcement and see that they are faithfully carried out.

We have therefore steadily gone ahead in the execution of this policy. The organized forces for reform have again taken up their burden, and are on a campaign throughout the country

in an effort to arouse the states and communities to a realization of the part they have to play, and the necessity of their playing it vigorously and promptly.

Meantime the Federal agencies have been reorganized on a plan of decentralization, the Federal Judicial District having been used as the unit in order that an intimate and active teamwork may be established throughout all the field forces of the Department of Justice and of the Treasury Department. Our representatives have been instructed to share with the District Attorneys the making of such cases against law violators as can be promptly and effectively prosecuted with the greatest effect for the common cause of law enforcement. The main objective of our energies is clearly defined to be the commercialized liquor traffic in all its manifestations. Our field forces are organized and our regulations made with the definite object of wiping out this traffic. The instructions to our field forces are to concentrate their efforts along specified lines looking to this end. Much energy, however, is dissipated by the continuing necessity of doing more or less local police work until the communities relieve us of this task. And I foresee that there will always be the need of rendering more or less assistance to state, county and municipal officers where local conditions are so unsatisfactory as to demand it.

It has taken time to effect the necessary organization and lay the necessary legal groundwork for the accomplishment of this Federal function, but real progress is now being made. In practical language, we have undertaken the elimination of the sources of supply for the organized liquor traffic, and the prosecution of the men who have organized and are conducting this traffic. These sources of supply are: smuggling, the diversion of industrial alcohol, the illegal manufacture of real beer in old time breweries, the diversion of medicinal spirits, the diversion of sacramental wines, and illicit manufacture in wild-cat distilleries and breweries.

Thanks to our executive agreement with the British Government, and to the negotiation of treaties with our immediate neighbors, marked progress has already been made against smuggling, and we are now confidently looking forward to the day when the smuggling of liquor in quantity will be completely done away with.

Thanks to the special appropriation of funds by Congress in June of this year, we have been able to organize special forces which are engaged in cleaning up the industrial alcohol field, steadily eliminating, one by one, the permittees who have engaged in illegitimately diverting alcohol to beverage uses. Great progress has been made already, and it is but a matter of time when all these permits will have been revoked, and this source of supply of alcohol eliminated.

Similarly for the supply of real beer, the same appropriation made possible the organization of a special force for this work, and with the aid of additional legislation requiring permits for manufacture of cereal beverages, we believe that this source of supply will be gone next season.

While much has been done by regulation to reduce the diversion of medicinal spirits, the existing law which authorizes the owners of spirits to sell in an open competitive market to wholesale and retail druggists, and to other permittees, has proven an insurmountable obstacle to complete control, and Congress will be asked at this session to pass remedial legislation which will make the control of medicinal spirits absolute.

Great difficulty was found in the issuance of sacramental wine, particularly to the Jewish faith, where lack of church organization and discipline made control almost impossible. This was a prolific source of supply. But a solution was finally arrived at, and the amounts of wine now issued for sacramental purposes are reduced to such an extent that diversion to illicit traffic has become negligible.

There remains as a source of supply illicit manufacture in wild-cat distilleries and breweries. As the other sources have been more and more controlled, the liquor traffic has turned more and more to this final source. Illicit distilling, whose product is known as "moonshine," has always been practiced in a small way; but this practice has developed under the prohibition Law, and become more or less nation-wide. When used as a source of supply in quantities sufficient to justify an organized traffic, this must remain the objective of the Federal forces, and will require special organization and close attention for its elimination. But where quantities are small, and for local use and distribution only, these violators must be definitely the objective of local law enforcement agencies. We are approaching here the phase of law violation where the individual citizen manufactures intoxicating beverages within his home for his own use. It is clear that this should never be the object of Federal control. Under our present conceptions of the functioning of democratic government, this is clearly for the communities themselves as a matter affecting most intimately their community standards of living and ideals of social government and welfare.

I must call your attention to one other phase of the government's function under the National Prohibition Act. We have to administer this law through our permit system wherever it touches business and professions which use alcohol or spirits in their legitimate undertakings. Alcohol plays a vital part in many important industries, and it is government's function to encourage legitimate industry. We have literally thousands of permittees more or less dependent upon the functioning of our Federal offices for the success of their business. Going back to the first of our two fundamental considerations determining policy and procedure, and regarding the consideration that the law must have popular approval in order that it may be successful, it is a definite part of our policy that we shall administer the law in a liberal, prompt and courteous manner, thus commending it to popular approval. Determined efforts are being made to bring our personnel to a high standard of character and personal conduct in office. All are enjoined to a scrupulous observance of law in both personal and official conduct. They are to be an object lesson in law observance and in respect for law. Wherever our functions touch legitimate business, our offices are enjoined by promptness of action and fairness of judgment to make legitimate business feel that government is working with them for their success. In determining questions of general policy at headquarters, we are trying to impress the general public with the fairness and liberality of our judgments, to the end that existing resentments may be softened, and a better appreciation may be had of the law and its social and economic effects.

IN CONCLUSION

To sum up, the Federal Administration is assuming that the peoples of these United States intend to carry on faithfully under their present form of

government, and will willingly reassume their duties and responsibilities as citizens under self-government; and the Administration is therefore actively working toward the day when the Federal Prohibition Unit will be a dignified efficient organization, engaged in the administration of the permissive features of the law to the satisfaction of the business public concerned, and in the execution of the enforcement features of the law by such close surveillance of the possible sources of supply and avenues of traffic as will prevent the movement of liquor in commercial quantities into any local jurisdiction; and engaged through cooperation in helping state, county, and municipal authorities, to make possible the success of their own expressed determination to live as social communities free from the presence of that traffic in liquor which they have denounced as a crime in their social existence. We can and will do our part. The people can do theirs.

Social Aspects of Federal and State Control

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THE inevitable conflicts which arise in two overlapping or intertwined jurisdictions in which quasi sovereign or independent powers of government are exercised, may be considered in respect of the economic factor, or the legal factor, or the social factor involved. It is probable that no one of these factors can be completely isolated and considered apart from the others, but we may at least attempt in the present discussion to emphasize the social factor in order to understand better the complex problem of jurisdictional conflict which is economic, legal and social.

Importance of Economic Factor

The economic factor is concerned chiefly with the extension of uniformity of standards applicable over the widest possible area of governmental activity. The legal factor has to do with the maintenance of the integrity of the separate jurisdictions and of that delicate and necessary balance or equilibrium implied in the constitutional arrangements designed to secure a maximum of equality and liberty to both. The social factor, however, comprises those forces and processes which express and formulate standards of conduct and institutional practices consistent with the type of social organization found in the separate jurisdictions.

A stable and efficient government depends on a clearly defined, well understood and generally accepted distribution of powers between its component parts. This is particularly true of a federal-state type of government, such as we have in the United States where the citizens owe allegiance to a dual sovereignty. It is still more true in a dynamic era of rapid social and economic change in environmental adjustments.

Three general propositions concerning Federal and state jurisdiction in our American system receive practically unanimous assent. Indeed in present-day discussion they are usually considered axiomatic. They are:

First, the power to regulate or control must be coextensive with the thing to be regulated, that is with the problem that furnishes the subject-matter of control.

Second, the final say, or the ultimate power that determines decisions of policy, whether expressed in legislation or in administrative action, should reside in the people nearest to the persons directly affected in the exercise of control, that is in the smallest units of political organization, consistent with the ability to ascertain and execute the popular will.

Third, in order to secure economy of administration and to avoid friction and unnecessary conflict of jurisdiction, there should be a minimum of overlapping of jurisdiction and no twilight zone in which no authority is competent to act, and forces subversive of either jurisdiction may operate to weaken or paralyze the efficiency of the power or authority in either or both jurisdictions.

Admitting the validity of these general propositions, and granting for the sake of argument that the facts of our constitutional history to date show that our state courts of last resort and the Supreme Court of the United States have consistently approved a course of permissible governmental action which fairly well harmonizes with these generalizations, we are still confronted with many unsolved problems in the ancient and ever more pressing task of making democratic government efficient. How can the collective intelligence and resources of the community be mobilized and brought to bear upon the task so that the social aims and the highest social standards of an undisputed majority of the people can be realized? That is merely another way of stating the social factor in the conflict of Federal and state jurisdiction.

It may be well to emphasize a fact that is often overlooked that it is the *majority* standards and their effective realization which constitute the real social problem. The protection of minorities in their clearly defined constitutional rights when exercised so as not to be subversive of the will of the majority is quite another problem, more of a legal nature than social. The abuse of minority rights and the tyranny of minority rule constitute a still different problem having its roots in defective social organization. There are, of course, standards of minorities, and sectional standards in process of an educational evolution which may emerge as the majority standards of tomorrow. That is another problem entirely. Educational forces can well take care of that, though it may be necessary to invoke the compelling force of legal sanction and governmental support in order to protect minorities in the rightful use of educational methods to those ends.

The most striking illustrations of the rôle the social factor plays in jurisdictional disputes will be found in the domain of labor legislation. In the long and hard fought battles to regulate the length of the working day, the economic factor finds its solution in approximate uniformity of standards secured by various means in competing states and in reciprocal arrangements between state regulation in employments that may be largely interstate in character, and Federal regulation in interstate commerce subject to exclusive Federal control. Thus, after the eight-hour day had become the rule rather than the exception in the basic industries of the country, secured by Federal and state legislation for governmental employments, by state legislation for many employments, and partly by trade union agreements in private employments, the Adamson law, a Federal enactment, made the eight-hour day the basic day in railroad employment, subject to necessary exceptions due to the peculiar requirements of that industry, and thus brought the Federal jurisdiction into harmony with the conflicting state jurisdiction for other industries.

The twelve-hour day in continuous industries has been practically abolished by a gentlemen's agreement in the iron and steel industry, adopted recently by almost unanimous consent of the chief establishments involved, which were so highly organized and centralized that they were able to control the action of a large part of the industries affected and the rest had to follow suit. That was done through co-operative action and without legislation. It has not yet been confirmed or extended by legislation. Neither is the result secure and permanent until it is embodied in protective legislation making it part of a definite social policy. This particular agreement or public understanding is perhaps better

enforced than most of our social legislation. The social factor, however, is not fully met by an arrangement that merely demonstrates the economic truth that a shorter than a twelve-hour day will not put continuous industries out of business. The question whether workers, who must devote twelve hours to earning their living with the added time incidentally consumed in working a twelve-hour day, have sufficient time left to meet the requirements of citizenship, of family and community responsibilities in accordance with the minimum standards of an American democracy, is a social question. No conflict in jurisdictional control, whether governmental or industrial, should be tolerated that will prevent the execution of the deliberate verdict or decision solemnly arrived at in that matter.

The slowness with which we apply the collective powers of government in the solution of such questions is due not so much to our traditional individualism as to the ineptitude of government itself and that in turn is due in large measure to jurisdictional conflicts. Mr. J. M. Keynes, the well-known author of *The Economic Consequences of the Peace*, *The Economic Consequences of Mr. Churchill*, and the economic consequences of many other things, has pointed out in a recent brilliant essay on "The End of *Laissez-faire*" that the paralyzing influence of *laissez-faire* on economics and more particularly on legislation in the 19th century and down to the World War must be attributed in large part to the mistakes, the failures and the incapacity of governments to deal with the social factors in public affairs. That is true of the United States as well as of England and here it is accentuated by the conflicts of Federal and state jurisdiction which so often have hamstrung both authorities.

It is high time we faced the facts. We must cease to rely on legal patchwork and changes in the mechanics of governmental organization if we hope to secure efficient execution of well considered and widely approved social aims.

CO-OPERATION AND CONCURRENT POWER

There are at least two bits of recent experience which throw light on the possibility of Federal and state co-operation. The first one is the matter of child labor prohibition and regulation.

CHILD LABOR

The first Federal child labor law, an act to regulate child labor in interstate commerce, approved September 1, 1916, to go into effect one year later, assumed that the Federal authority could, under its exclusive power over interstate commerce, do within the domain of the Federal jurisdiction all that was necessary to make uniform certain standards already adopted and enforced under state legislation within the domain of state jurisdiction. The second Federal child labor tax law, enacted in 1918, assumed that the tax power of the Federal authority would accomplish the same purposes when the Supreme Court decided that the commerce clause of the Constitution did not give the grant of power assumed in the first child labor act. But the Supreme Court held that the taxing power likewise was inadequate for these purposes and indicated that an amendment to the Constitution giving a direct grant of power would be the best way to secure the co-operation of Federal and state governments in this kind of control. Congress replied by submitting in June 1924 the 20th Amendment not in the form of an exclusive grant of power to the Federal Government but on the basis of concurrent power; but to date this amendment has been ratified by only four

states. The significant lesson of this experience is not the present fate or future prospects of the Child Labor Amendment, but rather what we may learn from what happened during the brief periods when these two laws were in full effect before they were held invalid by the Supreme Court.

The record of co-operation and avoidance of conflict is a remarkable one already made public in a recent publication (Bu. Pub. #78) of the Children's Bureau in the United States Department of Labor, which was the Federal agency charged with enforcement of the first act and co-operating with the Bureau of Internal Revenue of the United States Treasury Department in that of the second.

During the time when those two acts were in force, we had precisely a similar situation with respect to the administration to that we would have had if there had been a constitutional amendment like the Prohibition Amendment, or if the grant of power had been explicit in the Constitution. What happened? The forty-eight state jurisdictions, nearly all of which had dealt with this subject for a long time, developing standards that approached the minimum standards of the Federal law in some cases, exceeded them in many cases, and fell below them in only a few, rapidly adjusted their laws and their administration to those minimum uniform simple fundamental standards which were necessary in their several jurisdictions to the exercise of power to be co-extensive with the problem to be handled, which was almost nation-wide. In the course of the enforcement of those essential fundamental standards, a few simple things, not the details of child labor regulation that would appeal to the most enlightened communities as necessary to protect their working children, nor those that would appeal perhaps to people in many communities, as proven by the various standards enacted and enforced in other communities, were done by the Federal Government which greatly strengthened and enlarged the local standards.

In the administration of the first Federal child labor law there was no serious difficulty, friction or conflict between the Federal Government and the states. There was on the contrary a fair distribution of duties. The two jurisdictions worked together. There was a principle of co-operation, which we may well borrow from private industry and apply to governmental tasks.

PROHIBITION AMENDMENT

The second bit of experience is that with national prohibition, which we need scarcely more than mention after the very interesting exposition of its history and present plans of its administration by General Andrews.[1] Here we have concurrent power specifically provided for and the Supreme Court has interpreted it to mean clear cut definite power for each jurisdiction in its own sphere to deal with the same thing at the same time or at different times and to the same extent as the other, without any bugaboo of double jeopardy either, for the citizen is simply made answerable for his conduct to both sovereignties to which he owes allegiance by virtue of his dual citizenship. The meaning of concurrent power, as judicially construed in the leading national prohibition cases decided June 7, 1920,[2] and its possibilities for usefulness in the solution of the social factor in the conflict of Federal and state jurisdiction, as reaffirmed and amplified in the Vigliotti [3] and Lanza [4]

[1] *See* page 77.
[2] *Rhode Island* v. *Palmer* 253 U. S. 350.
[3] 258 U. S. 403, decided Apr. 10, 1922.
[4] 260 U. S. 377, decided Dec. 11, 1922.

cases and in the still more recent Dora Herbert case, decided in November 1926, merits serious consideration and research on the part of the student of political science who seeks a solution of the problem of jurisdictional conflict.

The Prohibition Amendment provides for its enforcement and the enforcement of the laws pursuant thereto, on the theory of co-operation by the Federal and state governments by the second section of the Amendment which says: "The Congress and the several States shall have concurrent power to enforce this article by appropriate legislation." The Supreme Court has held that this provision of the Amendment is within the amending power, is a part of the Constitution and "must be respected and given effect the same as other provisions of that instrument," and that it is "operative throughout the entire territorial limits of the United States" and "of its own force invalidates every legislative act, whether by Congress, by a state legislature, or by a territorial assembly, which authorizes or sanctions what the section forbids."

"CONCURRENT POWER"

The Court has also held that "concurrent power" does not enable Congress or the several states to defeat or thwart prohibition, but only to enforce it by appropriate legislation, and that it does not mean joint power, or require that legislation thereunder by Congress to be effective shall be approved or sanctioned by the several states or any of them; neither that the power to enforce is divided between Congress and the several states along the lines which separate or distinguish foreign and interstate commerce from intrastate affairs. The power granted to Congress in this section of the Amendment, while not exclusive, is territorially co-extensive with the prohibition of the first section and is in no wise dependent on or affected by any action or inaction on the part of the several states or any of them. Likewise the words "concurrent power" were construed in the Lanza and other cases to protect the states in the exercise of all the powers they possessed previously or subsequently not inconsistent with the Amendment and without depending in any way on the act of Congress or the exercise of Federal power within their territory. Says the Court in the Lanza case:

> We have here two sovereignties, deriving power from different sources, capable of dealing with the same subject-matter within the same territory. Each may, without interference by the other, enact laws to secure prohibition, with the limitation that no legislation can give validity to acts prohibited by the Amendment. Each government, in determining what shall be an offense against its peace and dignity, is exercising its own sovereignty, not that of the other. It follows that an act denounced as a crime by both national and state sovereignties is an offense against the peace and dignity of both, and may be punished by each. . . . This view of the Fifth Amendment (containing guarantee against Double Jeopardy provision) is supported by a long line of decisions by this Court.

Space will not permit here a discussion of the double jeopardy problem, which is not a serious one in the enforcement of social legislation nor likely to defeat the real purpose of the constitutional guarantee, which was to protect the citizen from judicial or executive tyranny. Indeed, while double jeopardy is of course repugnant to the spirit of our laws and institutions, something akin to it may operate to make social legislation more binding and enforceable and thereby contribute to give law-abiding citizens the benefits of laws which they have enacted for their welfare, which is an equally

good, substantial and valuable guarantee to that of not being "subject for the same offense to be twice put in jeopardy of life or limb."

Concurrent power opens vistas of possibilities for the realization of the three general and quasi axiomatic propositions concerning Federal and state jurisdiction in our American system of public polity with which we began this discussion. The late President Harding, in his celebrated Denver speech of June 25, 1922, on law enforcement, sensed this solution of jurisdictional conflicts and of the social problems involved. He said:

> The problem of concurrent jurisdiction is not a new one brought to us with the Eighteenth Amendment. It is as old as the Federal Government. It has required to be dealt with by Congress and legislatures, by executives and courts, in a multitude of relations to commerce, finance, transportation, and indeed the whole realm of concerns in our complex society. It has demanded our attention in all the multitude of issues ranging from the regulation of trusts and transportation, and even of certain relations with foreign governments, to the proposal for a uniform statute of marriage and divorce.
>
> There have always been those who insisted that particular policies could not be carried out because of the conflict of jurisdiction; but experience has proved that whenever a given issue became so acute that evasion was impossible, procedures have been devised for dealing with it. Whoever will go back to the debates over the enactment of the anti-trust law, or the discussion of the interstate commerce measures, must recognize that these were but varying phases of the same general question that comes before us in connection with the enforcement of the prohibition law.

It would seem that the theory and principle of concurrent power might be worked out so as to make jurisdictional conflicts less of a territorial matter and thus reduce their number and difficulties to matters which could be settled more on their merits and less on technicalities of law.

If jurisdiction can be clearly defined there is ample precedent for the assertion that governments have adequate power to be efficient in the exercise of their constitutional powers. The Federal jurisdiction finds this ample authority in the special grant to Congress in the Constitution (Sec. 8 p. 18)

> to make all laws which shall be necessary and proper for carrying into execution the foregoing powers and all other powers vested by this Constitution in the Government of the United States, or in any department or officer thereof.

As for the states the decisions of the courts of last resort and of the United States Supreme Court in making effective the system of workmen's compensation for industrial accidents furnishes the most striking illustration of how constitutional limitations may be broadly construed to meet new conditions in a revolutionary change in social policy where jurisdictional powers are clearly defined.

The Supreme Court of the United States, in three ruling cases, handed down in 1917, nearly ten years ago, and arising in three separate states of New York, Iowa and Washington, presenting different constitutional question, [5] established the validity of compulsory Workmen's Compensation laws under the police power of the states. There were a great many questions, doubts and conflicts that various state courts had judged somewhat differently, and decided somewhat differently which the Supreme Court finally cleared up, and the interesting and significant thing to the political scientist and sociologist, in those decisions, is the

[5] *N. Y. Central Railroad Co.* v. *White*, 243 U. S. 188; *Hawkins* v. *Bleakly* (Iowa), 243 U. S. 210; *Mountain Lumber Co.* v. *Washington*, 243 U. S. 213.

clear enunciation of the principle that, where the power is clearly defined as being derived from the police power of the state or vested by the state or Federal constitutions, the necessary powers to carry that out efficiently go with the vested or derived powers. In other words, the Court brushed aside a great many questions that had caused difficulty in the state courts, on the distinct theory, clearly laid down, that the right of a state legislature to enact a compulsory compensation law under the police power of the state carried with it necessarily the right to do those reasonable things that will enable the state to enforce such a law. Those decisions are worth examining. We will find in them a good deal that is significant for the new experiments in our constitutional history with concurrent power which will determine jurisdiction,—experiments destined to become more and more necessary and inevitable as time goes on with the increasing complexity of social and industrial life.

Our past history, if carefully scrutinized, will allay most of the fears of Federal overlordship. We shall find that our constitutional history does not justify the fears that have caused so many people to hesitate in making political decisions that would solve some of our problems of conflicting jurisdiction.

State and local legislatures as policy-forming and determining organs of government are not doomed to extinction, but are destined to play a larger and more important rôle in a social policy that makes possible and guarantees minimum uniform standards on a national or even international scale, commensurate with the problems to which they apply, and at the same time makes possible and guarantees no less positively the initiation and development of policies built on those minimum standards, but enlarging and applying them within narrower limits. More important still is the need for a social policy that provides the fullest possible co-operation in both Federal and state jurisdictions in the technique of administration and in securing efficiency in the enforcement of law.

The Controversial Subject of Federal Control in Education

By Dr. Frank Pierrepont Graves
President of the University of the State of New York and State Commissioner of Education.

WHEN we started on our career as a nation, there was no provision made for a Federal department of education, and we are for the first time in our history seriously urging that one shall be created. When advocating this proposition, we should not be misled by certain utopian remarks made by various Fathers of the Constitution—Washington, Jefferson or Madison—into maintaining that they wished to have such a branch of government immediately established. They never visualized any such thing as a reality. Their statements represented one of the many ideals that they vaguely hoped some time in the future might be materialized, and to quote their visions as a patriotic argument in favor of the present concrete project, as has been done by some enthusiasts, is both idle and absurd. On the other hand, it is quite as far-fetched to point to the tenth article of the Constitution, wherein it is stated that all powers not expressly granted to the Federal Government are to be reserved by the states, as evidence that the Fathers were opposed to a national department of education. Either of these arguments involves the "historian's fallacy," and reads back present day thought and conditions into an older period.

From Ideals to Facts

As a matter of fact, the founders of the Constitution gave no serious thought to education. Indeed it was not until about the time of the Civil War that we were generally able to have education unified even under state control. It was a generation later than that in the South, and some of us at the head of state systems are somewhat skeptical as to educations being even yet as fully centralized in the states as would be for their best interests. Certainly we shall make little progress one way or the other by quoting historic statements as precedents. Whether we are to have a Federal department or not will have to be determined by a presentation of our existing facilities and needs.

We did, indeed, make a slight gesture toward federalization in 1867, when, through the influence of General Garfield and others, we established what was for a year or so known as a department of education. But we soon repented of our rashness and reduced the so-called department to an innocuous bureau, which it has remained ever since. It is quite innocent of all real powers, with a commissioner of education at the head who receives one-third the salary of a state functionary, and it is limited largely to the collection of statistics and to reporting and disseminating its findings.

It was not until 1918 that we began to have visions of anything larger. In that year, as a result of revelations from the draft, we found some most unhappy shortcomings in our educational system, which forced us to pause in our complacency and take thought. The National Education Association, keenly awake to the situation, then appointed a committee, which, with the aid of other educators of experience and training, soon presented a report. This led to the formulation of a bill for the creation of a Federal Department

of Education, headed by a secretary in the President's Cabinet, and for a vigorous attack upon the abuses that had been found to exist in education throughout the country.

The work of this N. E. A. committee and the resulting bill may be regarded as a most expeditious and creditable performance, but they did not begin to possess the accuracy—not to say omniscience and infallibility—to which the authors seemed to lay claim. That is shown by the number of times the proposed legislation has had to be changed. Starting in 1919 as the Smith-Towner Bill, it became successively the Towner-Sterling, the Sterling-Reed, and the Reed-Curtis bills, until the creators would hardly recognize their child, and no one knows what it will look like at the coming session of Congress. In all legislation, concessions must be made, of course, but if the sponsors of the proposal had been a little less confident and more willing to conciliate, upon two occasions at least the bill might have been enacted and received executive approval.

PURPOSE OF THE BILL

The bill in its various forms, however, as we have seen, has always had two chief ends in view. One purpose was to remove the defects revealed by the war, such as illiteracy, inadequate teacher training, and neglect of physical education. This improvement it was proposed to accomplish by means of apportioning additional Federal funds, aggregating one hundred million dollars, to the various states according to their needs. Naturally the proposal was not received with any great enthusiasm by the wealthier states, which had already found from bitter experience with previous Federal subsidies that it meant paying out five or six dollars for every one they received back, and they insisted that all states could perfectly well meet the necessary school expenditures if they but had the will to do so. This the proponents of the bill have made it their business to refute by showing that educational outlays in the various states correlate fairly well with their actual wealth.

A more serious objection made by the opponents is that the distribution of funds by the Federal Government is sure to lead to interference with the systems of the several states and to the establishment of an educational bureaucracy. The advocates, however, claim that nothing could be further from the intention of the bill, which limits the prerogatives of the national department to an annual audit.

The other main object of the bill is to cure a serious looseness in the national administration of educational interests. Through the lack of a centralized agency, the government has distributed the functions of education among about forty departments, divisions, bureaus, commissions and boards, with overlapping and conflicting powers, and it would seem to be high time that some unity in purpose was established for education. This has led to an expression of fear on the part of certain opponents—President Butler in particular—lest our national government be completely changed and the functions of education be absorbed and dominated by a remote body in Washington, while the people in the various states are absorbed in matters at home. The obvious answer, which will probably be made to this argument, is that transportation and communication have been so expanded and facilitated that San Francisco is actually nearer to Washington today than Philadelphia was at the time that the Constitution was created, and that there is little ground for the assumption that governmental functions will be carried on in a pocket without knowledge of the people.

Wanted: An Active Coördinated Government Bureau of Education

By Dr. Samuel P. Capen
Chancellor, The University of Buffalo

THE issue of a Federal Department of Education is for the moment largely academic rather than political, it seems to me, but I am persuaded, nevertheless, that more individuals in the United States are interested in this issue than in any other issue now before us as a nation except prohibition. The individuals who are interested are not so vociferous as certain other groups and they have not learned how to make themselves politically as effective as some others, but their aggregate number is enormous. It runs into the millions.

There have been before Congress in the last eight years a number of bills, beside the famous Smith-Towner Bill and its successors, bearing on the question of the extension of Federal influence in education or on the improvement of the Federal Government's operations in this field. I do not remember just how many there have been, but they must number more than a score. Of course the major ones have been proposed by the educational forces. A good many others have been proposed by members of Congress to pacify or to forestall the educators. I suppose more legislation has been suggested on this subject than on any other important subject in the same period of time. As I have studied the reports of the hearings on these measures and read the periodical literature dealing with the question, there has kept coming to me with renewed force the impression that much confusion of mind exists both among educational people and among members of Congress. The confusion, I think, is both as to the appropriate function of the United States Government in such a field as education and also as to the possible effects of measures that have been proposed.

The Function of Government

We have derived certain principles of governmental action during our experience of one hundred and thirty odd years. I think the principles that I am about to try to enunciate are more the result of accident than of anybody's design. But however they may have originated, they are at least plain. The Federal Government is engaged in two essentially different types of activity. The first type—and the one we most commonly think of when we think of the government of the United States—is represented by the set of activities that are necessary for the organization and protection of the United States as a national entity. Such things, for example, as raising revenues, conducting foreign relations, providing for communications throughout the country, administering justice and providing for national defense. In the prosecution of all of these activities the government must exercise mandatory powers. It always has exercised them. It cannot exist unless it does. If necessary it must back up its decisions in these fields with all the physical force of the nation. These activities are coeval with the life of the nation and they are represented in the structure of the government today by the older group of departments—

Treasury, State, War, Navy, Post Office, etc.

However, as the nation grew and its life became more complicated, and as modern inventive genius brought new devices to civilization, the Federal Government was forced by the pressure of its citizens to concern itself with another set of activities entirely different. This set had nothing whatever to do with the organization and protection of the United States as a nation. It is the group of activities which roughly might be classified as productive or creative. In dealing with these the government has evolved —and I think largely by accident—a quite different technique.

The activities that I have tried to classify as creative are such activities as agriculture, commerce, labor, health, social welfare, science, education. Some of these already are represented in our administrative machinery by separate executive departments. But how have those departments on the whole proceeded? Their job has been very different from the task of the older departments. It has consisted largely of promotion, of stimulation with either no control at all of the interests concerned or with very little control. Or stated in other terms, the function of the government has been primarily to furnish facts and information, to solve problems, and to coordinate the work of many individuals and groups within the states through outstanding national leadership. Think back in your minds over the history of the Department of Agriculture, or the Department of Labor. The Department of Agriculture originally had no mandatory powers. It was an information office, the business of which was to inform the agricultural interests of the country, to solve some of its scientific problems, to persuade the individual members of that great interest to improve their processes. The same was certainly true in the beginning of the Department of Labor. The Labor Office was an office for the ascertaining of facts, the solution of problems, and it had no administrative jurisdiction.

I said a moment ago that it may have been largely accident that the departments dealing with the creative activities of the nation had no powers in the beginning. At any rate, it seems not to have been clear to Congress that they should never have any powers, because of late years there has grown up a tendency to give to the Department of Agriculture, to the Department of Labor and to the Department of Commerce, laws to enforce, subsidies to distribute and regulations to carry out. In my own private judgment the helpfulness and influence of those governmental organizations has been weakened every time any one of them has been endowed with a new set of powers. Now if you agree with me that there is this distinction in the activities of the government, and that the technique of the government should and ought to be essentially different in prosecuting these two types of activities, then it is patent that if Federal influence in education is extended, as many people wish to see it extended, there must be very clear recognition of the limitations on the government's proper sphere of action in this field.

PRESENT GOVERNMENT ACTIVITIES

We have been told that the Federal Government does various things in the field of education. I do not know just how many Federal offices at the moment deal with education. When I was connected with the Government some six or seven years ago there were about forty different Federal offices with educational functions, most of

them making some kind of appeal at times to the educational systems of the states. The majority of these enterprises were rather inconspicuous and I know that some of them have since been abolished. But we still have several different important centers of educational work in the government establishment. The one that comes to everybody's mind first is the Bureau of Education, which was created some sixty years ago and the principal function of which is to collect information, to disseminate it, and to make such studies of educational problems and situations in the United States as it is able to make. It is a small office in the Department of Interior, very inadequately equipped for its task. Then there is the States Relations Service in the Department of Agriculture, a very large and potent office, which distributes subsidies under the Smith-Lever Act, directs the experiment stations and is in general in charge of the agricultural educational efforts in which the government interests itself. Further, there is the Federal Board for Vocational Education, which distributes more subsidies under the Smith-Hughes Act and makes more investigations. It has a good deal of power. I might mention others, but these are the most conspicuous and they will serve by way of illustration.

Now is the service that we get from those several agencies sufficient and is that sort of organization satisfactory? I think the answer of the educational profession has been emphatically "No" to both of these questions. That kind of service is not sufficient and certainly the organization is very far from satisfactory. The profession is not animated by a fanatical desire to federalize everything. Its leaders are not mere Utopians who think that if they can get money out of the government they can overnight improve the educational enterprise of the country. They are dissatisfied because the thing the government has already set out to do is done so badly and inadequately.

WHAT IS WANTED FROM THE GOVERNMENT

I think it is fair to say that the profession—all of the profession and a good share of the lay public as well—now want from the Federal Government three things that are certainly not provided. The first thing they want is coördination of the government's own effort in this field. They want to have these several offices at least on speaking terms with one another and at the moment they have absolutely no relation to one another. No one of them knows what the other is doing. They carry on their activities as if they were in different countries and often the suggestions and instructions emanating from them are mutually conflicting. If the government is going to spend a good many millions of dollars a year on education, as it now does, then the profession and the understanding lay public want to see the governmental enterprise better organized. We want some scheme of consolidation.

The second thing we want is provision for carrying on large scale investigations of educational questions. In the end, all our principal educational problems become national problems. There is a constant reference upward out of the sphere of local inquiry until the great questions have to be studied nationally. We have no facilities whatever at the moment that are commonly within reach of the members of the public or of the profession for getting our great problems studied. What do we do now if we have an important question that we wish to have investigated, a question that affects the country as a whole? We go

to the educational foundations and beg for a subsidy. Practically all of the important educational problems of the last ten years that have been studied nationally have been studied under grants from the Carnegie Corporation, or the General Educational Board, or the Commonwealth Fund, or some other educational foundation. These studies are all very expensive. Their cost is likely to run from $50,000 to $200,000. They require an expert personnel which has to be assembled for the purpose. It is a tremendous piece of work for the profession to get one of these national investigations launched and get it completed. In view of these difficulties and of the importance of such studies, we desire an agency to which the profession can turn, that the profession in a sense owns, to perform these great national tasks as they present themselves.

Let me cite a few examples of the kind of studies I have in mind. Immediately after the war with the change in the purchasing power of the dollar, probably the most pressing problem for schools was the financial problem. What should we do about it; on what level must the schools be supported in order to live, with this wholly different economic base? Finally the American Council on Education got $200,000 from four different foundations and set a commission to work on that task and the Educational Finance Inquiry was made. There was a good deal more delay than there should have been and the auspices, although as suitable and effective as any, were certainly no better than would have been a proper government agency. Again, every time the N.E.A. comes together it discusses the curriculum. The curriculum question is a national question. We have no means either of investigating it nationally or of bringing together and distributing nationally the results of local investigations.

The third thing that I think both the educational group and the lay public desire from the Federal Government is leadership. That is a little more difficult to define. As we know, leadership is where you find it. It resides in human beings and not in bureaus or institutions. But when a great national study is made only half the task is done. It has to be interpreted. It has to be made to tell or else its influence is certainly cut in half. What some of us would like to have connected with the government in the field of education is a kind of personal leadership which will make as effective as possible the scientific investigations which the government carries on. Occasionally we have secured such leadership in the United States Bureau of Education. Leaving recent history wholly out of account and simply citing the past, such leadership was there when William T. Harris was Commissioner of Education. What some of us would like, then, is to have a national agency set up that would appeal to a William T. Harris, if we could find another one, as a worthwhile post from which to exercise his great talent.

Now, can these things be secured without a dangerous extension of Federal authority in this field, without real Federal control? I think they can. I think that if the earnest promoters of the Smith-Towner Bill and some of its successors had shown a little more sweet reasonableness at different times, we should have had these things already, because the objection to the Smith-Towner Bill and the Towner-Sterling Bill and the others was that those measures carried with them inevitable control through the large subsidy features. One may dogmatize about this as much as he likes,

but it is the history of the government that, if continuing subsidies are dealt out, the office that deals them out also has coercive power.

HOPEFUL SIGNS

There have been several propositions before the Congress that would give us what we desire without the dangers of control. For instance, a consolidation inside of some existing department of at least two of the existing education offices, namely, the Bureau of Education and the Federal Board of Vocational Education, and the setting up of machinery for working relationships between the consolidated offices and all other offices of the government that deal with education would probably accomplish the ends the educational profession has in view. Such a proposal appeared a few years ago. It was known as the Dallinger Bill. It seemed to me to have very considerable merits.

There is also another promising possibility. The report of the Committee on Government Reorganization, filed two or three years ago, provided for a regrouping of services in the several departments and the creation of one new department by assembling different services that belong together and are now located in different government agencies. The new department was to be called the Department of Education and Relief or Education and Welfare. That plan would have given us both the service and the leadership that I have been advocating.

Finally, I think that the last measure before Congress proposed by the educational people themselves, creating a separate Department of Education, without any subsidy feature, providing also for a consolidation of the government's educational enterprises, and strictly limiting the functions of the department to research and publicity, would furnish what some of us believe to be necessary. I am persuaded that the operation of such a department would be attended by no invasion of the educational autonomy of the states.

I agree with those who fear the encroachment of Federal authority. But let us make no mistake; there is eventually going to be a large extension of Federal influence in education. The obligation both of the profession and of the lay public is to make sure that the legislation which provides for this extension shall strictly define the new government agency, whatever it be, so that it will exercise just those functions that have proved to be profitable to the interests concerned, and that it shall have no powers whatever to control education throughout the country.

Federal Subsidies for Education

By Austin F. Macdonald, Ph.D.
University of Pennsylvania

DURING the last fifteen years Congress has worked out the details of a system of grants or subsidies from the Federal treasury to the states, which has enabled the Federal Government to exercise a considerable measure of supervision over matters not mentioned in the Constitution, and, therefore, presumably left in the hands of the states. Seven large grants and a number of smaller ones of this type are now made regularly from the Federal treasury to the state governments, with total congressional appropriations exceeding $125,000,000 annually. Four of these are for purposes which may be definitely labeled as educational. They are:

(1) the Smith-Lever Act of 1914, which provides for agricultural extension work;

(2) the Smith-Hughes Act of 1917, establishing what has become a nationwide system of vocational education;

(3) the Fess-Kenyon Act of 1920, providing for the training and placement in industry of physically handicapped persons;

(4) the Sheppard-Towner Act of 1921, which provides for instructing mothers, present and prospective, in the care of their babies.

The Acts providing for the establishment of the agricultural colleges and the agricultural experiment stations should properly be omitted from the list because they contain practically no provision for Federal supervision.

Features in Common

All the recent subsidy laws have certain features in common. First, they provide for the payment of money from the Federal treasury to the states. Second, they make these grants to the states on the basis, generally speaking, of population. Third, the money paid from the Federal treasury is paid to the states conditionally. Certain stipulations must be met before the states are entitled to receive Federal funds. These conditions are: (1) acceptance of the act by the state legislature, which involves setting up within the state an adequate administrative agency; (2) the matching of Federal funds. Every state is required to put up a dollar of its own money for every dollar it receives from the Federal Government. This feature of Federal aid has led some to dub it the "fifty-fifty system." (3) The state administering agency is required to submit detailed plans of its activities, which must be approved by the Federal bureau in charge. In each case the work is done in the state by state officials, but with a certain amount of Federal supervision.

Remarkable progress has been made under the various subsidy laws. The history of Federal aid is a story of transformed agriculture; of vocational schools with thousands of students in states which formerly did not have a single course in vocational training; of hopelessly disabled cripples, transformed into happy, independent wage earners; of states which for the first time are giving their mothers an opportunity to find a solution for the problems of motherhood, and offering their babies for the first time a real chance for life. Few of the people who oppose Federal subsidies maintain that the work is being improperly done, or that it is unnecessary.

OBJECTIONS RAISED

There are some exceptions, of course. Just a few months ago former Governor "Jim" Ferguson of Texas took a fling at the Children's Bureau. "It is supposed to teach Texas mothers how to have babies," he cried, "in spite of the fact that the mothers of this state have made a success of having babies for over a hundred years." One is reminded of the story of the trained welfare worker who went to visit a mother of the slums. The woman became quite irritated. "So you're tryin' to teach me how to raise children," she said, "me that has buried seven."

Most of the opponents of the Federal subsidy system, however, take their stand on very different ground from Mr. Ferguson. They advance five main objections to Federal aid, with a great many variations. One is that these various functions are purely local in their scope, and that their solution is a problem for the states, and not the Federal Government. But when problems exist whose effects extend to the uttermost parts of the nation, it is difficult to believe that their solution rests entirely with the local communities.

Is education, whether it be vocational training for high school students, better knowledge of crops for farmers, better knowledge of babies for mothers, or better knowledge of their economic potentialities for the physically handicapped, purely a local problem? That question was well answered by John W. Abercrombie, Alabama State Superintendent of Education, when he said:

> Already over twenty millions of our people are residing in states other than those in which they were born, and it is no longer possible to permit a child to grow into citizenship in ignorance anywhere without endangering every other citizen everywhere.

Another objection frequently made to Federal subsidies is that they are stifling local initiative, and that the people are sitting back in complacent indifference. Such a statement is manifestly absurd. Competent and impartial observers in every state of the Union add the weight of their testimony to the vast mass of statistical data that without Federal funds most of the states would never even have attempted problems they are solving to-day. When the records show four or five states carrying on the work of civilian rehabilitation or child hygiene in 1918 or 1920, and forty or forty-five doing it in 1926, largely with state funds and entirely through state officials, it is difficult to believe that local initiative is being stifled and that local responsibilities are being shirked.

COURT DECISION

Three years ago the Supreme Court of the United States settled definitely the constitutionality of the Federal subsidy system. The twin cases of *Massachusetts* v. *Mellon* and *Frothingham* v. *Mellon*, brought to determine the constitutionality of Federal aid, were dismissed for want of jurisdiction; but the Court, speaking through Mr. Justice Sutherland, went on to make a number of observations which, though in the nature of *obiter dicta*, are highly illuminating. Said the Court:

> Probably it would be sufficient to point out that the powers of the states are not invaded, since the statute imposes no obligation, but simply extends an option which the state is free to accept or reject. . . . But we do not rest here. What burden is imposed upon the states, unequally or otherwise? Certainly there is none, unless it be the burden of taxation, and that falls upon their inhabitants, who are within the taxing power of Congress as well as that of the states where they reside. Nor does the statute require the states to do or yield anything. If Congress enacted it

with the ulterior purpose of tempting them to yield, that purpose may be effectively frustrated by the simple expedient of not yielding.

Clear, straightforward language, direct and to the point. Yet that decision was handed down in 1923, and two years later Governor Ritchie of Maryland declared:

> It simply cannot be argued that the Federal Government has any right to use Federal funds as a means of acquiring a control over local state purposes, which under the Constitution is not granted to the government but is reserved to the states. That, under our present Constitution, is simply indefensible.

Apparently not even the Supreme Court of the United States is able to convince the opponents of Federal aid that it is constitutional.

WHAT THE STATES THINK

Another argument frequently raised against Federal aid is that it is paternalistic, that it tends to create a uniform mould into which all state administration must be cast; in other words, that it serves as an excuse for Federal officials to cram Federal policies down the throats of the states. Nothing is further from the truth than charges of Federal domination. The domination consists of a three- or four-day visit, once a year, by some Federal official to each state, supplemented by a searching scrutiny of the state's accounts, and a most careful examination of the plans submitted by the state. In each case the plan of activities is prepared by the state itself through its own officials, and varies with their concept of their state's needs. The Federal supervising bureaus have nothing more than a sort of veto power and they are careful to exercise that power with the very greatest infrequency. This summer I talked or corresponded with one hundred and forty-nine of the state officials administering the various subsidy laws for education. I missed only twenty-nine. These are the men and women who are "suffering" from Federal bureaucracy, whose intimate knowledge of local conditions is being ignored, we are told, by ruthless Federal officials. And every one of the one hundred and forty-nine, with not a single exception, declared in the strongest possible manner that there was no thought or question of Federal domination, and that Federal co-operation had been kindly and helpful in the extreme. Most of them went on to say that without the stimulus of Federal funds their state programs would not have reached the point where they are to-day for the next fifty years. If that be domination, then the more domination, the better.

SUPPLYING AID WHERE NEEDED

Perhaps the most potent argument of the opponents of the Federal subsidy system is that it is economically unsound, because it results in a transference of wealth from the richer to the poorer states. Federal revenues are derived primarily, of course, from the wealthier states, while Federal subsidies are paid out, generally speaking, on the basis of population. The result is that some states get back far more than they pay in while others receive far less. Tables have been worked out by the distinguished Governor of Maryland to show that some states are receiving in Federal subsidies less than one per cent of the amount they contribute to the Federal treasury in the form of income taxes, while others are receiving anywhere from 100 to 300 per cent. Such tables are obviously misleading. They credit to New York State, for example, the amount of the income taxes paid in by the Union Pacific and the Southern Pacific rail-

roads, which do not have a single mile of track east of the Mississippi River. Likewise they credit to New York the entire income tax paid by the United States Steel Corporation, which has more stockholders in Pennsylvania than it has in the Empire State. If the total wealth of the several states, or their total current income, or some combination of the two, were used as the basis of comparison, the results would be quite different. The disparities would be just about one-fourth as striking. Whatever the method of computation, however, it is obvious that Federal subsidies are not distributed among the several states in proportion as they contribute to the support of the Federal Government. There seems to be no good reason why they should be. Probably it has never been suggested that river and harbor appropriations or Federal post offices should be proportioned to the share of Federal taxation borne by each state. Now that such questions are being raised, they should be met squarely. Are we prepared to ignore the striking differences in the ability of the several states to support education, requiring each state to work out its own salvation—or condemnation? We compel the rich man, even though he be childless, or though he chooses to send his children to private school, to contribute to the support of the public school system. Are we going to permit the wealthier states to neglect their responsibility for the establishment of at least a national minimum of educational opportunity in this country? Or shall we recognize frankly that the Federal subsidy system brings to the poorer states a measure of financial relief, and that it brings to all the states a stimulus and a leadership that could come from no other source than the Federal Government?

State and Federal Jurisdiction in Education

By Charles R. Mann, Ph.D.
Director, American Council of Education

With regard to the question of the Federal Department of Education and its relation to the states there has been active discussion for the past eight years. Up to date, nothing practical has happened in the way of a change of the Federal office or offices and the creation of a new department. We cannot, however, regard the eight years as wasted on that account, because we must remember that in a democracy success is not measured by the objective achievements always, but rather by the growth of the people. No one who has followed the argument for the past eight years can deny that people have grown in understanding of this problem enormously. Therefore, it has been enormously worth while. The important thing is to note the direction of that growth and the rate at which it is taking place.

This discussion has had certain obvious benefits in ridding the majority of those who have taken part in it of several obvious fallacies. I think the majority of us, certainly more than half of us, are convinced of the fallacy of the fifty-fifty subsidies. I am sure that the state legislatures have learned that they are not getting something for nothing on a fifty-fifty subsidy from the Federal Government. I am sure that the Federal Government and Congress have learned that that fifty-fifty subsidy really does carry control, although really on the face it would seem not to do so. Hence, one of the advantages that has come from this discussion is the exposure on a wide scale of the fallacy of the fifty-fifty subsidy.

Another of the very perplexing problems that has become clearer is the relation between wealth and the support of schools in a state. We all know offhand that there are vast differences in the wealth of the different states and in their ability to support schools. But these figures concerning taxable wealth are extraordinarily misleading because there are no uniform tax laws in the states, and because the definition of what constitutes taxable wealth is not clearly understood. You all recall that a few years ago North Carolina made a re-assessment of state property for tax purposes, and when the re-assessment was finished, North Carolina's taxable wealth was four times what it previously was. Nothing had been changed in North Carolina except figures in books. That sort of uncertainty in the taxable wealth figures makes them very elusive in dealing with this problem.

It is interesting to note in passing that in all these lists we have seen, Mississippi is somewhere near if not at the bottom. Yet every one who knows Mississippi knows that during the last ten years it has made very notable progress in the development of a consolidated rural school system of its own, at its own expense. These taxable wealth figures you see fail to take account of the unused energy of the people which can be liberated without money and without price in an educational enterprise that grips them. That is what happened in Mississippi.

Another exploded fallacy is the assumption that equal educational

opportunities are secured by equal expenditures of money. It has been implied in many of the arguments that in order to secure equal educational opportunities, with which I am heartily in sympathy, you must spend approximately the same amount of money per child. The relation between per capita cost of education and educational opportunity is again very obscure, and we are in great danger of going wrong if we lay too much weight on figures. These are some of the fallacies, or some of the questionable beguiling points, which have led us astray in the past, and on which we are becoming much more clear.

FACING A NEW SITUATION

In education we are at present faced by a totally new situation which has been developing so rapidly that few of us have grasped its significance. This new situation has been brought about by the war, by our great industrial growth, and by the opening up of our international relations. The thing to do now in facing this question of Federal relation in education is to try to make an estimate of the new situation and in the light of that estimate to make a plan as to what ought to be done. I would like to take up the question from that point of view.

In this new situation it seems to me that there are three very significant and outstanding features. The first of these is a change in the nature of public demand on the schools. This change has been going on gradually for a great many years. But the war crystallized opinion. It seems to me that the public is now demanding of the schools that they discover the capacities and abilities of each child and provide means for their maximum development. In prewar days schools had fixed curricula, and children were sent into these fixed curricula and were judged to be more or less failures if they did not conform. That idea has rather disappeared to-day. The fundamental demand of the public on public education is that somehow it find out or discover or cause the child to reveal to himself his own capacity and then provide methods for developing that capacity to the maximum. That demand presents a new problem for the schools.

If the schools are going to make good in solving that problem, it requires a large amount of experimentation. New devices, new methods of discovering ability, new methods of developing ability are required. This experimentation, which has been going on very markedly since the war, has led to the recognition of the fact that real control in school progress does not lie in the school authorities or in the state legislature or in the Federal Government. Real control lies in the facts which are discovered by means of this experimentation. Therefore, the second important feature in the present new situation is the rapidly growing conviction that facts control education. While governments control the administration of education, the actual processes of it are controlled by facts. An administrative system that operates in accordance with the facts makes the maximum success of the school system.

The third important feature of the new situation is that in this process of experimentation in order to discover facts it has been necessary to develop co-operation among large units. Statistical studies that lead to reliable facts require the compilation of data from a large number of cases. Very few school systems have enough cases. Therefore, there has developed a technique of co-operation among school units by which enough data are assembled to justify sound conclusions. The three factors that stand out in the

present educational situation are: first, public demand for discovering ability and giving it opportunity to grow; second, experimental study, which is leading to the conclusion that facts really control education; and third, the technique of co-operation which has developed for the purpose of enabling us to discover the facts which are really significant.

This situation is not peculiar to education. The same development is going on in the industrial world. Industry has made marvelous progress through invention and scientific study, but it is now coming to realize that the greatest opportunity for further development lies in releasing pent up human energy by discovering what a man can do best and giving him opportunity to grow. Industry and business are absorbing this new idea. They are making experiments and developing co-operative methods whereby they can compare results and make progress together. That being the situation, what can we in America do to hasten the rate of development? Those three factors determine the direction in which the progress is taking place. What can be done to accelerate progress? In particular, with reference to the subject of extension of Federal influence in education, what can the Federal Government do?

WHAT IS THE FEDERAL GOVERNMENT?

In order to answer this question it is necessary first to get a clear conception of what the Federal Government really is. There is a great deal of confusion with regard to the fundamental question as to where sovereignty rests in this country. In a debate recently one man said that we have a double sovereignty—national government and state government. That shows the confusion. Of course a double sovereignty is impossible. You cannot serve two masters. The complete statement of wheresover sovereignty rests has been given us by Dr. Judson in his recent book on *Our Federal Republic*, where he points out that each state is not sovereign within its own domain, nor does the sovereignty of the nation rest in the Federal Government. Sovereignty rests in the United States acting by a majority of three-fourths of the states. Therefore the Federal Government is not a government in the ordinary sense. It is an agent of this sovereign power, and therefore it is not a final authority but only acts as an agency of the sovereign power in matters delegated to it. Now that we recognize this fact, the idea of Federal control in education takes on a different aspect, because the Federal agency called the government in Washington has no more authority than is granted it by the sovereign United States acting by a three-fourths majority.

Now the thing that is needed, or the thing which this sovereign power might require the Federal Government to establish, seems to me to have been already described by Dr. Capen in his article.[1] It is a thing the states and individual communities need for their intelligent guidance. That is an agency which is competent to gather reliable facts and to disseminate them throughout the country. Such an agency would satisfy the demand of the situation for the facts that control education. Such a federal office is necessarily out of politics, because politics is finding more and more that it is helpless against facts, if the facts are reliable and well presented and derived on a large enough scale. Therefore, if the sovereign states request the Federal Government to establish such a fact-finding agency, there is little danger of it coming into politics if it remains true to its function. The

[1] See p. 97.

danger is becoming less and less every year as the recognition that facts control education expands.

If that is the nature of a Federal education office demanded by the present situation, it seems to me to be immaterial whether it is a bureau or a department. Its merit and success will depend upon the quality of work. There is a slight preponderance in favor of making it a department at the present time, because the budget arrangements in Washington are such that it is very difficult for a bureau to get adequate financial support. A department has direct access to the chief of the budget and can secure financial support more easily. But as a matter of achieving its function in education, it seems to me it is immaterial whether it is organized as a department or bureau. I am ready to leave that question entirely to Congress.

From all of this it appears that the present situation is most encouraging. This development, both in industry and education, of reliance upon facts in guiding action throughout the country is directed away from further centralization of authority or administrative function in Washington. I think my readers will agree that the greatest danger at the present time to American democracy is this tendency to let Uncle Sam do everything. This process now going on in education and industry is a direct antidote to the centralizing tendency. Co-operation and experimentation in finding facts operate to liberate local initiative and to stimulate local responsibility, and not to vest greater power in the Federal Government.

IN CONCLUSION

In conclusion, the question as to the jurisdiction of the states and the Federal Government in the matter of education may be concisely answered as follows: The individual states obviously have jurisdiction over their own education, if by jurisdiction you mean the administrative authority and the responsibility for the operation of educational systems. But final control of education lies in facts derived from experiments and experience in trying to meet the new public demands. The Federal Government, or Federal organization, can do its part in developing the educational system of the country by establishing a suitable and adequate fact-finding and fact-disseminating office, which will have influence and a stimulating effect upon the general development that is going on, but which will have no power in the sense of authority and no control.

The Dilemma of Giant Power Regulation

By John H. Gray
Washington, D. C.

NOTHING need be said here about the importance of power. Power is the very life of all industry. It is probable that electric power will mean more to the coming centuries immediately before us than steam meant to the 19th century. The necessity for regulation of industries which are affected by a public interest is thoroughly established in our minds and a fundamental part of our legal system. This doctrine was thoroughly embodied in our law by the Supreme Court in the famous case of *Munn* v. *Illinois*, in 1876. That decision declared the power a legislative power under our Constitution and one beyond the reach of the courts. Under that decision a rate fixed by the legislature directly, or by a commission authorized by the legislature to fix rates, was beyond judicial review. But the court soon became frightened at the radical movements, and in 1894, by dragging in the Civil War amendments, meant to protect the persons and property of the emancipated slaves, and declaring a corporation a person—forgetting that, if it is a person under these amendments, it must be a person of color—the court assumed the right of judicial review of legislatively fixed rates.

Court Rulings

The court said that the right to fix or establish a rate is a legislative power, but that, in view of three provisions in the Federal Constitution requiring due process of law and the equal protection of the laws, and requiring that public property be not taken by any state for public use except upon payment of just compensation, it was the duty of the Federal courts to examine, in a properly presented case, any legislatively fixed rates, and to void them, if they were in conflict with any one of these three provisions of the Federal Constitution. So far as this point is concerned, that is the law today. It makes the regulation of rates a slow, uncertain and expensive task. For, under this ruling, where the court voids a legislative rate on constitutional grounds, it cannot establish a just and constitutional rate itself to take the place of the rate declared void, that being strictly a legislative function under our system of government and the theory of separation of governmental powers. It simply voids the rate and restrains its enforcement. Then the legislature or the commission must begin all over again. The upshot of it is that, in law, the legislature fixes rates; in practice, the court determines what rates shall be made or enforced.

But this is only the beginning of trouble with the courts. For, under our system of jurisprudence, state courts and state commissions are each limited to the territory of their own states. They have no power to examine books or to summon witnesses outside their respective states. Since the firm establishment of the right to regulate, each of the states, with a single exception, has established a state commission, and the Federal Government has three commissions; namely, the Interstate Commerce Commission, the Federal Power Commission, and a Public Utilities Commission for the District of Columbia. The particular in-

dustries placed under these commissions differ in the different state jurisdictions, but in general they include electric companies, street railways, water, gas and railroads. The power of the state courts in this field has virtually disappeared, because in case of diverse citizenship of parties nearly all cases may be taken to the Federal courts, and for this purpose a corporation is a citizen. In this day of national industry, virtually every case may be taken to a Federal court. The difficulty is increased by the fact that control under the law does not extend to non-utilities. And in this day of holding companies most of these industries are controlled by holding companies, many of them not even incorporated, and if incorporated they are usually territorially outside the jurisdiction of a state commission in any particular local utility rate case.

INTERSTATE CONTROL

So far as electricity is concerned, the Federal Government has never assumed control over it. Reasoning from analogy, however, so far as electricity is transmitted beyond the state of its generation is concerned, it is subject exclusively to Federal jurisdiction and control. This follows, in my opinion, inevitably from the decisions in natural gas cases. The Federal Government has already nominally, that is, legally, assumed control over interstate telegraph and telephone service, but not over intrastate activities in this field. Up to date, however, this control, even over the interstate activities, has remained for the most part on paper only.

With the growth of Giant Power, and holding companies in the electric field, it is plain that control cannot be effective if exercised by these two distinct sovereignties, state and national, by two different bodies, and under two sets of laws. It is entirely problematical how far the Federal Government will permit the states to go in regulating the electrical industry in the absence of Federal action. But it is plain under the commerce clause of the Constitution that the Federal Government has exclusive control of interstate transmission of electricity. When it cares to assume such control, it will interfere and prohibit any state action in this field so far as in the judgment of the Federal courts it is necessary to do so to accomplish effective control of interstate electrical matters by the Federal Government. This follows from the decisions in the Shreveport case, the Minnesota Rate case and under the Transportation Act.

In the Minnesota Rate case, 230 U. S. 433, 1913, the court said of railroads:

> If the situation has become such, by reason of the interblending of the interstate and the intrastate operations of interstate carriers, that adequate regulation of their interstate rates cannot be maintained without imposing requirements with respect to their intrastate rates, which substantially effect the former, it is for Congress to determine, within the limits of its constitutional authority over interstate commerce and its instruments, the measure of the regulation it should supply.

Acting upon this and many similar rulings in other cases, Congress in the Transportation Act of 1920 specifically authorized the Interstate Commerce Commission to fix intrastate rates wherever existing or proposed state rates interfered with or burdened interstate traffic. The Commission has acted in numerous and important instances under this provision, and such action has been sustained by the Supreme Court.

It needs no argument to show that electricity has in fact become a national industry, and is destined to become more and more so. If it is to be pub-

licly controlled, it must be nationally controlled, under a uniform system of national laws. The diversity of citizenship and the growth of holding companies makes this inevitable. Any attempt to control the local part of the industry by one body and the interstate part by another body, each answerable to a different set of laws, and responsible to a different sovereignty, is doomed to failure. The control must be as broad as the industry and subject to uniform laws. Our experience with railroad control as well as reason teaches this.

PRESENT SITUATION

It is said that five holding companies now control forty-three per cent of the electrical industry. A single one of these companies now operates in twenty-two states and in more than twelve hundred municipalities. To show how impossible any state, or mere local control is, with its territorially limited jurisdiction, let us consider for a moment the character and method of operating of a holding company. A company is organized, incorporated, or not incorporated, and domiciled wherever it seems most advantageous to the promoters. It cannot be summoned into the jurisdiction of any state except that in which it is incorporated. If it is not incorporated it is not subject to control even by the state of its domicile. It is not necessarily an operating company or a public utility even in the state of its incorporation, if incorporated. Its affairs are practically a sealed book to all commissions or other public bodies.

It now proceeds to buy a majority of the shares of public utilities in different parts of the country and to operate the different companies each under its own name and charter. The holding company is in the eyes of the law a simple stock holder, not subject to more control than a private stock holder. The favorite way is for a single group of men to organize three separate companies, who buy the shares of many local companies in the name of one of their companies. The same small group of men, having a majority of all the shares of the local companies in ownership and control, elect themselves directors of the various local companies. They sit at one and the same table and do business in the name of all these local companies with their new holding companies of which they are also directors. When they have bought control of a given company they determine that the plant needs rebuilding. They vote as directors of this company to issue securities for this purpose. Then, still acting as directors of the given company, they make a contract with their finance company to float the necessary securities, paying such commissions and brokerage as they choose. Still acting as directors of the local company, they enter into a contract with their engineering company to rebuild the plant, again contracting with themselves, and paying such price as they choose. Again acting as directors of the local company, they enter into another contract with their new operating company to operate the plant, paying such a price as they choose. They sell securities back and forth among all the companies they control on such terms as they choose, and as often as they wish to, shift surplus or earnings from one company to another in this manner. They sell and buy coal and other material and electricity among their companies at will. For the essence of Giant Power is to pool the current and to connect all the plants with the pool and to draw from this pool as their financial desires dictate. Bear in mind that all the gains from all their contracts go to the same parties—that is, themselves—

and that they are always trading with themselves. Now, when the local company has a rate case these bare contracts may be brought before the state commission for that company has a domicile in the state of this commission and its contracts are usually open to the commission, but none of the conditions of the contract are known. The commission has no means of judging of the fairness of any of the contracts. All this is done clearly within the law. It ought to be plain to the dullest mind that with all these facilities concealment of the costs and profits of the service can be made within very wide limits, to appear exactly what the owners wish them to be. Under such a system of organization and operation with our limited territorial jurisdiction, state control is a farce.

A National Riddle

Enough has been said by me to show that the electrical industry is a national industry—a highly centralized industry in its ownership and private control and management. It is also clear that greater concentration is coming and that the great holding companies are more and more acquiring a community of interest, and are connecting their plants with transmission lines that are already almost continent wide. If the industry is to be publicly controlled the holding companies must all be brought under public control and their financial organization must be greatly simplified. But no state can do this because of its territorially limited jurisdiction, for under our dual constitutional system each state as a sovereign state is limited in all of its activities to its own soil. The Federal Constitution, in addition, prevents it from interfering with Federal affairs. So far as electricity is interstate, constitutionally that is an exclusive Federal matter.

Truly we are up against a first class dilemma. The right to regulate being a police power, neither sovereignty, without a constitutional amendment, can permanently surrender its regulatory power to the other. Notwithstanding the important interstate phase of the subject, a large part of the electrical industry is preëminently local in its character. Certain it is, that neither constitutionally nor practically can the whole regulation be left to the individual states with their limited jurisdiction and their jealousy and conflicting views and policies. We must work out some system by which the strictly local matters can be dealt with by public authorities that are easily accessible, that derive their powers from the various states and are answerable to their respective states. At the same time, the strictly interstate parts of the industries must be regulated nationally, by uniform Federal laws, by Federal officials who are at the same time thoroughly familiar with the local as well as the interstate parts of the industry. Any scheme of control, if all commissioners dealing with the subject are not thoroughly informed in regard to every fact in regard to the companies with which they deal, whether that fact relates primarily to interstate or intrastate activities, will fail. An interstate body cannot expend the time and money necessary to acquire the expert knowledge of the intrastate activities for the mere sake of controlling the interstate activities.

Suggestions Towards Solving

But three serious propositions for solving these complex problems have been made. They are:

1. To load the Interstate Commerce Commission with the interstate part of the control and leave the state commissions, as at present, in charge of the intrastate parts of the industries.

2. To provide by means of state

treaties or compacts for intersale control of the interstate parts of the industries by the state commissions with the consent of Congress, leaving the local control as at present with the state commissions.

3. To combine the whole regulation in the same body of men who shall, under suitable state and Federal legislation, act in the dual capacity as a state or a Federal commission for the territory of the state as circumstances may require.

Enough has already been said in regard to the first two propositions to show the futility of local control under our constitutional system. A nation-wide industry cannot be successfully regulated by any body whose jurisdiction does not extend throughout the whole nation.

The regulating body must have knowledge of all of the affairs of the serving company irrespective of state lines. The states can never get money enough or experts numerous enough or skilled enough, to get such knowledge. Furthermore, the Constitution forbids them to get such knowledge, even if they had the money and the experts. Every state authority the world over is limited to the territory of its own state.

The proposition to turn the interstate regulation of electricity over to the Interstate Commerce Commission is hopeless. In the first place, that commission has more duties placed upon it by existing statutes than it can possibly carry out. In the next place, the state jealousies and the controversies with state commissions would block the effective regulation of these industries by such a method. The nature of the industry would probably make difficulties here much greater than they have been in the railroad field and the difficulties of railroad control, because of these conflicts, are today after about forty years of wrestling with them almost prohibitive of effective control. This is still true, although beyond doubt the nature of the railroads makes it much easier, constitutionally, to extend Federal power over all railroads than it would be to extend the same power over the electric industry. In the case of railroads this extension has tended to kill local sentiment and, under present legislation, to increase greatly the evils of centralization and bureaucracy.

At present, the Interstate Commerce Commission is organized on a definite legal centralized system of administration and long established traditions. This is true to a degree to hamper greatly the effectiveness of regulation of the industries now under the supervision of the commission.

It would be sheer and unnecessary duplication, even if such were not the case, for the commission to try to acquire sufficient knowledge of the local phases of the electric industry to make interstate control effective. To make any control effective, the controlling persons, or officials, must have complete knowledge of the situation and of all affairs, state or interstate, of the companies with which they deal.

The proposition for state compacts seems to me impossible for various reasons. First, each of such compacts must have the formal and specific approval of Congress. While such compacts are numerous in our history, they are for the most part such as relate to boundaries and police and sanitary powers, and do not touch or directly influence larger conflicting and shifting industrial interests. From a psychological standpoint, they are virtually unknown to the public mind. But we are dealing here with a dynamic, shifting, changing industry of the first order. Most of the existing compacts settled their problems once for all, and,

at most, affected two or but a few states. We have here an industry that affects all the states. If we are to deal with it by compacts, we shall find, when Giant Power is fully developed, that we should have to have individual compacts affecting many states. The jealousies of the states, worked on by rival financial interests, would certainly prevent the successful negotiation of compacts as fast as they are needed, while the same influences would prevent the approval by Congress. The rapid development of the industry might easily make the compacts antiquated, with the need of amendment, before they could be approved by Congress. Every important economic change in the interstate development of electricity would require new negotiations and new appeals to Congress. They would be harder to deal with satisfactorily than the World Court protocol. Any such method would tend to block the industry, and, in fact, to leave it unregulated. American industry, in the present state of the public mind, does not wait upon slow and tedious negotiations.

The recent experiences of New York, New Jersey and Pennsylvania in regard to such negotiations in this field, and the attempts of seven states to apportion the power to be developed in the Colorado River do not encourage us to hope for much from such compacts. Had agreements been reached, what would have been the fate of them in Congress? If they had been approved by Congress, how long would it have been before new negotiations for amendments and new appeals to Congress would have become necessary? We may easily conjecture what would become of the multitude of such negotiations and such applications to Congress after Giant Power had spread over the whole country and electric current could be sent from coast to coast.

As soon as it is proposed to turn over the interstate electrical interest to the Interstate Commerce Commission or other national body, we run against all the traditions of states' rights and various complexes. These not only stir up violent emotions and still reason, but evoke certain unformulated assumptions as the basis of opinion and agitation. The unexpressed assumption is that any national regulation necessarily means centralized, nationalized, bureaucratic, slow, expensive and arbitrary administration of the power in question. We immediately, on the basis of this assumption, hear outcries about the inefficiency and expense of bureaucratic government. Truly, for reasons already hinted at, it would be impossible for the Interstate Commerce Commission to exercise this power effectively from one office at Washington with its present centralized method of administration. The Commission is already breaking down under its present duties with its centralized administration. If any national power is to be effectively exerted, whether it is that of the Federal Judiciary, the Interstate Commerce Commission, or the Post Office, the administration, while under uniform national laws and national inspection, must be decentralized, with most of the work done locally away from Washington. Above all, it must take advantage of local knowledge, local sentiment, and local pride. It must be so arranged as to save the endless delay and expense incurred in trying to do all the work from one central office. Few private businesses are as large, or as complex, or as difficult to administer, as the three departments of government just mentioned. No large private business has ever been effectively administered, and probably never can be well managed, with as highly a centralized management as we

have in these three departments of government today.

It would be as practicable, and as sensible, to try to do all the Federal judicial business of the United States from one office in Washington, without any district and circuit courts with all their judges and staffs, as it is to try to exercise essentially all the powers of the Interstate Commerce Commission from one office. But the evils of centralization would be much larger in the case of electricity than in the case of the railroads. The business is much more complex and dynamic, and much less subject to routine action.

Fortunately the logic of the situation calls for no such stupidity or for any such an attempt based on traditions, complexes and emotion rather than on reason. To recapitulate, we are apparently rapidly approaching an era when electric power will dominate our industrial life and will be generated in large central plants and distributed over high tension lines across innumerable state lines. Yet the industry is primarily of local interest, and, under our complex constitutional system, in its local phases, is subject to state and not Federal regulation. Nearly all the states have state commissions already in charge of such state regulation. These commissions have already amassed vast stores of information and a considerable degree of expertness in this field. Yet they are greatly hampered by the territorial limitations of their respective jurisdictions, and the national character of the owning and serving companies. The states are very loath to surrender any of their power, even if there was constitutional right to do so without constitutional amendments.

The industry already has interstate relations of ownership and operations of vital importance, and these are bound to increase in the near future. These phases of the industry are clearly exempt from state control or interference under the commerce clause of the Federal Constitution. Irreparable injury will result if we attempt to solve this problem of dual state and Federal control through the slow process of constitutional amendments. Neither state nor Federal control can be exercised effectively unless the persons exercising the control have complete authority to acquire, and actually do obtain, complete knowledge of the affairs, state and Federal, of the companies with which they deal. There is grave doubt whether, under present constitutional arrangements, either a state or a Federal constitution as such can be given legal authority to acquire the necessary information for exercising effective regulation within the field allotted to it. This is certainly true in regard to the state commissions. This argument leads inevitably to making the same persons at the same time state and Federal officers and agents.

Let Congress pass an act declaring that the state commissions in the respective states, for the time being, shall *ex-officio* become Federal agencies or commissions for dealing with the interstate phases of this industry. It would remain for the individual states to accept or reject this burden. It could not be forced by Congress on any state against its will.

Provision should, therefore, be made to lodge this power in the hands of the Interstate Commerce Commission where any state did not have a commission, or when the state refused to accept the power offered it by Congress. It could easily be provided that, in interstate relations where more than one state in a given instance was affected, the commissions of the states affected should for this particular case sit together as a joint or single commission.

Such an act would show such respect for the rights of the states and even for their sentiments and traditions, as would probably cause every state voluntarily to accept the act. It might even induce the only state now without a state commission to create a commission in order to protect its rights and take advantage of this act. There is little doubt, in my mind, that such legislation would so increase the dignity and prestige of the state commissions as to increase the grade of their personnel. Provision should also be made for a limited appeal to the Interstate Commerce Commission in the more important cases. But this right of appeal should be much more restricted than in the case of Federal courts. The present relation of the different divisions of the Interstate Commerce Commission furnishes a model for fixing the right of appeal from one of these Federal agencies acting within a given state to the Interstate Commerce Commission.

The present governmental arrangements in the District of Columbia, where the same three men act as commissioners for the District and also sit in a different capacity as public utility commissioners for the District, suggest the dual capacity for state commissioners as proposed here.

This arrangement would doubtless raise the grade of the personnel of the state commissions and increase the expertness of the members to a degree that would lessen very greatly the number of cases appealed to the courts. This would probably speed up the work and make all regulations, both state and Federal, much more effective. Every case, state or Federal, would be in the hands of men having complete power over all the companies, because they would have complete knowledge of all the companies coming before them in any case.

Regulation being an administrative and expert job, court review should be reduced to the lowest possible constitutional limits. With the increased standing and expert knowledge of commissioners, the courts would not only have fewer cases to deal with, but judges would probably come to have very much more respect for the decision of commissioners, and consequently would be much less inclined to reverse them. This would tend to put regulation in the hands of persons best qualified to exercise it and would add enormously to its effectiveness. Under such a system cases would be decided much more quickly, cheaply and equitably than at present.

The Concentration of Control in Power

By H. S. Raushenbush

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IN the field of public control of power several factors have, within the last years, challenged the adequacy of the agencies we have set up to deal with our public utility industries.

Some Challenging Factors

(1) The very size of the industry is one of these factors. Some of our public service commissions are devoting as much as three quarters of their time to the power industry on the basis of their old appropriations. In most states the Commissioners have small budgets with which they must not only handle the other utilities but meet interests with capitalizations running into the hundred millions, and follow to some extent at least all their moves in the line of intercompany contracts and mergers.

(2) These companies have in recent years been doing a land office business in acquiring each other and developing systems which in some cases have solid technical and geographical foundations and in others seem simply to be a combination of any properties which could be bought. The Northeastern is a sample of the former. The North American and Cities Service of the latter. The Cities Service has properties as widely separated as Washington and Connecticut, Canada and Oklahoma. The integration of the superpower systems spreading throughout the country not only have careful planning behind them, they have several careful and often competitive plannings behind them.

To meet the curious exigencies of various state laws and to take the due advantage which is sure to accompany creative initiative in the field of business and financing quite as much as in the field of the arts and letters, they have built for themselves a series of holding companies, which not only gather the profits of the operating companies in a less conspicuous manner than one such company could do, but raise a series of problems for the serious minded intending investors, and also for the consumer of light and power, for whom the state regulatory commissions are authorized to speak.

This challenge is, in the main, yet to be made explicit. We have met it before in the case of street railways which often held one company, in a suburb possibly, which was running at a loss, while the company in the city could still carry on at the old rates. The plea then was to consider the system as a whole, so as not to raise rates in the suburb. Some commissions have allowed this recognition of the holding company. Others have not, or not yet. Investigation of some of the financial set-ups in the power field, of some of the prices being paid for operating companies these days, leads to the conclusion that the power companies are expecting one or possibly both of two things: permission to function as a system, with recognition of the increased values of the system over the sum total of its parts (a non-Euclidean case, where the whole is more than equal to the sum of all its parts), or a decided decrease in the cost of power.

(3) A third factor changing the situation somewhat from its former

appearance is the growth of interstate business, a matter which at present is not under any public control where power is wholesaled across state lines. While the volume of such energy may never be more than a small fraction of the total energy generated, its importance to the general question of public utility regulation may be much greater than its ratio to the total.

The concentration of financial control in a few hands and the consequences of that are things to which we still have to become accustomed. We are watching an unchecked centralization of industrial control, accompanied by a very definite and purposive campaign for decentralization of both state and Federal control. This plea for decentralization is made under several names, one of which is "economy," and as a nation we are showing the good French characteristic of paying indirect taxes with good grace while objecting strenuously and effectively to direct taxes.

In the power industry with its spectacular engineering a good many financial doubts have gone down with open-mouthed admiration at massive powerhouses and long distance transmission. I believe that there is high authority for attributing our whole American wage level to the efforts of our electrical engineers. Certainly these have done more to carry the Rooseveltian anti-trust movement on their shoulders to its grave than the power financiers have done. Some idea of the size can be obtained from the fact that seven and a half billion dollars is now invested in the industry, and that within the last calendar year two billion dollars' worth of properties were involved in mergers and regroupings.

WHERE CONTROL IS VESTED

Five holding companies control very definitely 24,350 million Kwh., approximately 40.8 per cent of the central station output. First among these seems to be the Northeastern with eleven per cent of the total central station production. The companies under the supervision of the Electric Board and Share rank second with nine per cent; the Insull interests third with 8.7 per cent. Then come in order the North American (7.1 per cent) the Standard Gas and Electric (5 per cent).

The eight next largest companies control another 15,061 million Kwh. or 25.2 per cent of the total. These are the Southeastern Power and Light (4.4 per cent), the Edison United Companies of New York (3.7 per cent), the American Waterworks and Electric (3.7 per cent), the Pacific Gas and Electric (3.3 per cent), the Southern California Edison (3.3 per cent), the Public Service Gas and Electric (2.2 per cent) the Cities Service (2.1 per cent) and the Stone and Webster interests (2.1 per cent).

These thirteen companies have a direct control of sixty-six per cent of the total, and are further often connected among themselves in many ways, which would allow some of them to be considered as working identities of interest.

The Electric Bond and Share (which is a company co-equal with the General Electric, consisting of essentially the same stockholders, but having since 1924 a board of directors which does not interlock with the board of the General Electric) is financially interested in six of the parent or subsidiary companies of the other large interests as well as in companies not falling under their controls. Together with the General Electric it probably has an influence of some sort on over half of the power industry. Its revenues are derived from four main sources: (1) fees for financing the

companies and marketing their securities; (2) for supervising operating agreements on a stipulating basis; (3) for designing and building operating units; and (4) in dividends and interest from the securities of its supervised and associated companies. They stretch over thirty-three states. The Electric Bond and Share also has interests in five foreign countries through the American and Foreign Power Company, which it controls. The total capitalization of its owned and supervised interests has recently been put at one billion dollars.

The spheres of influence of some of the large holding companies are wider than their stock controls indicate. When stock is widely held, a good deal less than fifty-one per cent is necessary for control. Professor Ripley has stated recently in connection with power securities that "with 300,000 scattered holdings, fifteen and twenty per cent of the votes cannot be outmatched at an election."

The advantages claimed for the holding company are: (1) greater efficiency of operation, and consequent lower costs to the consumers; (2) cheaper financing of plants, additions and improvements. The proof of these puddings is in the fact that retail lighting rates throughout the country have gone down 6.25 per cent in the last six years.

This would not be so overwhelmingly impressive a price drop, even in a competitive industry which had been growing into the large-scale industry class as rapidly as the power industry has done. During these last six years production has increased fifty per cent, gross revenues sixty-six per cent and the operating ratio has gone down from its July peaks of 65.9 per cent in 1920 to 52.1 per cent last year. During this period the amount of coal used per Kwh. was reduced one-third from 3.2 pounds to 2.1 pounds. Large scale production and increased technical efficiency would at first blush seem to have been the main factors making for the rate reduction, slight as it was. Certainly much of the credit the holding companies take to themselves is that of shining in reflected glory. Certainly they are not responsible for *all* the tie-ins and power exchanges, most of all not when their interests are separated from each other by the width of several states.

Professor Dewing has taken twelve typical holding companies and shown that of their holdings fifteen per cent was in their subsidiaries' bonds, fourteen per cent in their preferred stock and seventy-one per cent in their common stock. Nearly three-fourths of their assets, in other words, represent a claim on earnings only after bonds and preferred stocks have received their share of the income. On top of these the twelve holding companies issued twenty-five per cent bonds, thirty-two per cent preferred and forty-three per cent common. In other words, the dividends from a large part of the common stock of the subsidiaries held by the holding companies have been transformed for all practical purposes from a contingent to a fixed charge. Some parent companies, like the Northeastern, have no funded debt and attempt to make capital out of that fact, in spite of the fact that all the bonds of their subsidiary corporations must be taken care of before the parent company stock can receive a penny. Professor Ripley in the November *Atlantic* has pointed out the danger of this pyramiding: that when the operating subsidiary has mortgaged fifty per cent of its income, a ten per cent drop in its earnings will cut the return available for its common and for the parent company one-fifth, and that when the subsidiary has mortgaged

eighty per cent of its income, a drop of ten per cent in the net will cut the dividends payable to the holding corporation in half.

The fact that this system works in the other way has accounted for the tremendous prosperity of the holding companies. An increase of ten per cent in the earnings of an operating subsidiary fifty per cent mortgaged will increase by twenty per cent the earnings of the company which holds all its common.

These, however, are matters which, at the moment at least, interest us as investors more than as consumers, except insofar as they indicate a large prosperity among the operating companies. In spite of the desires of a group of the Investment Bankers' Association for a unified, possibly Federal, control of security issues, the chances are that, in spite of the essentially investment banking function of the holding companies, control over their issues will come later than more rigorous control of the operating companies will come. The theory of protection to consumers in non-competitive industries is much more strongly entrenched than that of protection to investors.

EFFECTS ON OPERATING COMPANIES

There are, however, two ways in which holding company financing affects the operating companies, and it is with these that we are more immediately concerned. The first of these is that highly imaginative holding company financing, such, for example, as has been exhibited by the United Light and Power, will, unless all presidents follow Mr. Hulswit's example and donate a million of their own to their company after its crash, lower the rate at which their bonds and stocks can be put on the market. That this will affect the rate at which the securities of the operating companies can be marketed seems to me unquestionable. The second way is to some extent *in futuro* as yet, but people in the industry seem to give it a very present measure of recognition. It is the attempt, which may be expected, for the overcapitalization of the operating companies on the basis of their increased efficiencies *qua* parts of a large system and on the basis of their sales price to the holding companies. This is surely a look ahead, but that a very serious attempt along this line is in the cards I do not doubt.

President Ferguson of the Hartford Electric Light certainly foresaw overcapitalization of his operating company when he reported a refusal to join in the Northeastern merger in the words:

> Directors are fully cognizant of the tendency toward mergers and consolidations which has prevailed in the industry during the past year, but none of the suggestions or proposals made to date would seem to offer any material advantage to the stockholders to offset the *higher price of current to them and to the public* which must result from the recapitalization of the company on a much larger scale by a possible purchaser if the sale were to be effected at or above the present market prices.

The same fact was certainly in the mind of the Advisory Committee of the Narragansett Electric Light when it said, in connection with the proposed sale of that company to the United Electric Power, that the recent history of our public utilities has shown that the control of an extensive electric light and power system is regarded as having a large value aside from the intrinsic values of the properties involved, and that very large prices have been paid for a controlling interest in such systems. Regarding the effect of the plan for merger on the stockholders as *purchasers and users* of electric light and power, the Committee contrasted the

earnings now required by the Narragansett Company for its dividends and the amount that would be necessary to meet the dividends and interest requirements of the new capitalization. Dividend payments made by the Narragansett amount to $1,880,000 and

> Under the proposed merger the interest and dividends, which the plan contemplates shall be paid, amount to over $3,300,000, an increase of over 75%. This tremendously increased disbursement must come from earnings and as the customers are the only source of earnings, this eventually means higher prices than otherwise necessary . . . even if rates for light and power should not be increased, it is obvious that they will not be decreased as much as they naturally would without this tremendous increase in interest and dividend requirements.

The annual savings to be effected through a combined use of the power plants are insignificant as compared with this increased dividend requirement, amounting to only about $150,000 to $200,000.

In New York State such prices, of which the Public Service Commission takes note without having control, are the rule rather than the exception.

In February of this year the Mohawk-Hudson, a holding company in a stock exchange, acquired the common of the Northern New York Utilities Company, paying $80 for $60.

The Mohawk-Hudson bought the Syracuse Lighting, a United Gas Improvement interest, paying $347 in market value for stock with a book value of $106 and a market price some months before the sale of $265. In this case the vending company, the United Gas Improvement, held a fifteen per cent interest in the purchasing company.

Last year the Buffalo, Niagara and Eastern, a holding company which later became part of the Northeastern merger, bought the Niagara Falls Power Company, and the common stocks of the latter company, an operating company, which had a book value of $26.17 and a 1924 market high of forty-seven, rose to sixty-nine at the time of the merger and later attained a 1925 high of seventy-seven.

This twenty-two to thirty point rise in a half year for stocks of an operating company, supposedly held to an eight per cent return by our regulatory system, cast a *prima facie* evidence of doubt on the adequacy of that regulation. When we find that, due to lack of an adequate budget, the Federal Power Commission has not been able to come to any agreement with this company on the net cost of its investment and that the company in spite of a prescribed system of accounting carries an item of over thirty-two million dollars in undistributed assets on its books, there is adequate reason to believe that much more than a fair rate of return is being enjoyed, or, to put it more concisely, much more than a proper rate base is being allowed.

I am using this as an illustration of the new situation which confronts our regulatory system. This company sells to large industrial users along the Niagara frontier, some of whom hold stock in it. It wholesales to allied companies, the Buffalo General Electric among them. An allied transmission company, the Buffalo Lockport and Ontario, distributes part of its energy. The Public Service Commission, with its hands full, and its budget inadequate, with a membership not selected according to mastery of the economic and legal intricacies of valuation work, with a practice of acting only when complaints are brought, of course receives no complaints from the allied interests and does not investigate. And yet this is the largest hydro plant in the country and represents, I am told, the cheapest power this side of the

Canadian border. Here is practically an air-tight set-up.

DANGERS IN HOLDING COMPANY CONTRACTS

There are certain of our public service commissions which are convinced that the danger of increased costs or inadequately reduced costs to the consumers lies in the holding company contracts. The commissions have not had much success with the regulation of these in the telephone industry, where the American Telephone and Telegraph makes contracts with its state subsidiaries. These are essentially contracts with itself. Yet the Supreme Court has said that the local regulating board has no right to pass judgment upon the wisdom of the contract; that unless collusion can be proved, it must stand, regardless of its possible improvidence; that the local company is entitled under the constitution to earn enough to meet the terms of the contract and in addition earn enough to give a reasonable return upon all property locally employed in the industry.

The chairman of the Department of Public Utilities of Massachusetts puts this danger of the holding company line-up in the following words:

> What purpose is there in these mergers pyramiding their paper on top of the local companies? Who is to pay interest and dividends on all that paper?
>
> The only way in which it will be possible to make good these various pieces of paper the mergers are issuing is, it seems to me, through their being able to obtain valuable contracts with the distributing local companies. Contracts which will run for a long number of years; and although not apparently bearing excessive terms at the outset, at least to the public eye, yet in the process of time, they having the field, with the growth of the business and the growth in the electric industry increasing much faster than the growth of the invested capital,—by growth in the volume of business they will be able to get enough profit through these contracts to pay interest upon a lot of paper which represents practically nothing at the present time, except various good wills and theories of people that the values of these various properties are such that they ought to be allowed to issue the paper against them.

On these holding company contracts we have as yet relatively little data, only such data as the commissions themselves bring to light. The Indiana Public Service Commission, for example, recently found a contract between the Commonwealth Power Corporation (a holding company on which the American Superpower is heavily represented), and the Southern Indiana Gas and Electric, an operating company, whereby the former received ten per cent of the total cost of extensions, additions and betterments to the electric, gas heating and other properties, and two per cent of the entire gross earnings from all departments of the company. This was by way of compensation for general management and supervision service. The Commission, although granting the increase in traction rates asked by the company, denounced the contract as "simply a process of milking the patrons of the utility and obtaining an enhanced return on the investment."

In March the Michigan Public Service Commission expressed a sincere but probably futile hope, which seems to be all the satisfaction left to the commissions by the court decisions in the matter of holding company contracts. Allowing the four and a half per cent contract of the Michigan Bell with the American Telephone and Telegraph, it said:

> Although all of the operating expenses which the Supreme Court held should be allowed have been allowed because of its opinion, when and if the position of that court shall be modified, reservation is

made of the right to compel the Michigan Bell Telephone Company to disgorge any money taken under the so-called 4½ per cent contract in excess of what it shall ultimately be determined it is entitled to receive, and the right is also reserved to recover such amounts as have been taken from the public by telephone rates to pay a return on reinvested depreciation reserve, used for the purpose of earning and paying dividends thereon to its stockholders.

These holding company contracts seem to reach their finest flower in the soil of interstate business where wholesaling across state lines is completely uncontrolled. In March the Maryland Public Service Commission found that the Consolidated Gas, Electric Light and Power Company was renewing a contract for the hydro power from Holtwood, Pennsylvania, at the rate of six mills, at a time when the power was being produced at 4.9 mills in the company's own plants. The companies have several directors in common.

WHEREIN THE COMMISSIONS ARE HANDICAPPED

In other words, the hands of the commissions are fairly well tied by an arrangement which is the outstanding feature of regulation in the industry. The Michigan Commission reserves the nominal right to recapture if and when the Supreme Court changes its mind. Massachusetts goes on record that in any long-time contract between companies for the sale or exchange of electricity the approval of the Department of Public Utilities must first be obtained.

The situation is made more difficult by the decision in April of the United States Supreme Court in the appeal of the Board of Public Utility Commissions of New Jersey against the New York Telephone Company. This throws the additional onus of very quick action upon the regulatory bodies which are not quick in action. That amazing decision was to the effect that the company had a right to a fair return on its surplus earnings arising from sums contributed by consumers over and above the fair return on its rate base. The customers must pay a return not only on the "value," rather than the cost, of property bought with funds contributed by investors, but also on the "value" of property bought out of earnings.

One of the two places where a halt can be called and apparently is called on the undue charges for construction, management and sales of current by holding companies and on the constant circle of reproduction costs and values, is where the Federal Waterpower Act can be enforced. At Conowingo last winter, because the development lay partly in Maryland and partly in Pennsylvania, the Federal Power Commission in co-operation with the two state commissions was able to cut out the largest share of capitalized expectations. The project's cost was put at fifty-two million dollars. The company holding had an elaborate setup of subsidiary companies and proposed to issue, in addition to the allowed bonds and preferred stocks which completely covered this fifty-two million dollars, an additional 94,200 shares of no par common in two classes, only one of which would carry the voting power. This overissue, which is in our best utility practice elsewhere, was disallowed. Not only was the main investment held down to the net cost, but provisions were written into the various leases and contracts between the generating, transmitting and distributing companies stating expressly that subject only to unanimous agreement to alter them by the three commissions the rentals should return only seven per cent on the actual legitimate investment. But there are not many Conowingos. The bulk of the power

is steam produced and the Federal Waterpower Act does not apply.

IN CONCLUSION

To sum up the situation: the public service commissions are confronting increasing complexities raveled before them by very expert gentlemen. The commissions are in many cases financially unable to do more than tackle a few parts of the problem presented to them. In some cases they do not even investigate rate bases or returns unless complaint is brought, and with subsidiaries purchasing the power, complaint is not brought directly by any consumer. Further, the courts have upheld holding company contracts; they have also allowed the vicious circle of rates and values to constantly increase the rate bases of the properties; they have allowed a return on the surplus out of earnings and have generally assumed a controlling say in the matter of regulation which holds little hope for its future unless the states insist on writing into all new charters, contracts and leases the principles of the Federal Power Act.

Federal and State Relations in the Control of Power Development and Distribution

By Philip P. Wells
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MOST of the debate over the powers and duties of the Federal and state governments in dealing with our economic life beats the air in a war with shadows. It is a discussion of unrealities. The realities of this problem of power development and distribution are economic realities, but the debaters are blinded to them by phantoms from the world of politics.

Take the State of Connecticut, for example. It is only a part of southern New England, the great finishing shop of American manufacturing enterprise. Upon Connecticut's small water powers the creative ingenuity and energy of its people, generations before the age of electricity, laid the foundations of the industrial greatness of the little commonwealth. The small water powers are intensively developed but were long since outgrown. Today the chief source of the life-stream of energy for Connecticut mills is in the coal fields of Pennsylvania. The margin of undeveloped water power within the state is small. So much for sources of supply. On the side of demand Connecticut today is too small a territory to be an economic unit of electric service. The mere political fact that it is a sovereign state does not overcome these handicaps in dealing freely with this new economic force. Its industrial fate depends on interstate commerce in electricity—on cheap mass production of electrical energy at sources in other states for transmission over its borders and on an integrated power pool for distribution embracing many states.

Compare Connecticut with the State of Texas—an empire in area in which we could sink a superpower system without a ripple on the borders. Or take the State of California, in which for more than a decade electric current from a water power site midway of the state north and south has been delivered near the southern border, five hundred miles away. The contrast between the California situation or the Texas situation and the situation of Connecticut, or any one of the New England States, with the possible exception of Maine, clearly shows that New Englanders, in making an issue of Federal authority against state authority for the control of power service, are not dealing with realities.

Disguises and Deceptions

Let us look critically at some of these phantoms. In the first place there is an underlying assumption in many minds that the relation of the state to the nation is by nature a relation of antagonism. The Fathers of the Republic knew better. They made the nation the common agent of the people of all the states. They foresaw joint and friendly action by the two parts into which they divided the sovereignty of the American people. Outstanding examples are: The provisions of the Constitution for co-operation of states and nation in organizing, arming, disciplining and governing the militia of the states; for the nation's guaranteeing to every state a republican form of government and protection against invasion and domestic violence; and for approval by Congress of inter-

state compacts. Our history records numerous instances of joint and friendly action of nation and state, but it remained for the Roosevelt administration, in our own time, to set forth in a proper light, as a major political principle, the idea that co-operation, not antagonism, is the proper relation of national and state power. This was forcibly brought out in the report of the Inland Waterways Commission, a report closely related to the struggle over water power. The political idea underlying the Inland Waterways Commission report, and many other acts of the Roosevelt administration dealing with natural resources, was that the state and the nation should so co-operate in their regulation of natural resource disposal that there would be no twilight zone on the borders of their authority without any public control at all. The Federal Water Power Act was built on that theory.

Moreover there is—shall I say insincerity—no, that is too strong a word—there is deception on the part of those who argue for one side or the other of this fictitious issue, and it is very often the most dangerous kind of deception, namely self-deception. The supposed issue is deceptive in two respects that I will mention here. It is supposed to coincide with the issue of centralization against decentralization in government; but, as a matter of fact, Federal activity does not necessarily mean centralization. The administration of the United States Forest Service is decentralized. The administration of the United States Reclamation Service was decentralized before its degradation was begun a dozen years ago. Most important of all, the real issue behind this debate over Federal authority and state authority, the hidden but true issue, is most often the issue of property against personality, of money against men. That is the reality which frequently lies behind this discussion. That was so with respect to the fight for the conservation of natural resources. It was especially so in the long battle over water power which ended in the Federal Water Power Act. That struggle lasted fourteen years and from the beginning to the end of it the clamor for state rights was continually raised against the proposals of the conservationists, raised in the halls of Congress, in the courts, in contests before the executive departments; but never once was it raised save in behalf of the men who demanded water power grants in perpetuity without those conditions essential for safeguarding public rights which were finally embodied in the Act. From the beginning to the end the deceptive hand was disguised in the hide of state rights, but to the understanding ear the telltale voice betrayed the would-be uncontrolled monopolist.

The same thing is true about the controversy over the Maternity Act. To some extent it is true about the controversy that is coming over blue sky laws. For example: Pennsylvania has an admirable blue sky law, admirably administered, in such a way that it has won the praise of great banking houses. Yet some very strong financial interests, instead of adopting the policy of co-operation with the states in this matter, have come out for a Federal blue sky law, and the reason is obvious—they can market their bonds better if a good law is spread all over the country than if there are many bad spots left.

The reality behind the water power controversy in particular and the electric power controversy in general is, in the last analysis, that it is a struggle over who is to get the benefits that are to come from the development of our natural resources; because of course electric power comes either from water

power or from coal, with a negligible amount coming from oil and natural gas. That this is the real issue was illustrated with respect to water power in the original set-up of the Conowingo project. A clause in that set-up provided that the price to be paid for the electric current generated by water power from the Susquehanna River was to rise and fall with the price of coal. That provision was disallowed by the Federal Power Commission, but such was the proposal.

GETTING DOWN TO REALITIES

So much for the phantoms. Now let us get down to the realities. In order to keep for the people of the country—the consumers—their fair share of the benefits to be derived from these natural resources through privately owned corporations operating under public regulation, certain things have to be done, either by the Federal Government or by the state governments, and the choice of which government is to do them is a choice of expediency, to be determined in the light of the constitutional powers of those governments and of the practical situation. These things are realities. The first of them is that the amount of money upon which the constitutional right of the investor in the enterprise to a fair return is to be calculated, must be limited to the amount of money actually paid into the enterprise by the investor with reasonable prudence. That rate-base is sometimes called the "prudent investment" rate-base. In the Federal Water Power Act it is called the "net investment." This rate-base is written into the Federal Water Power Act, and the state commissions, in regulating the rates charged for electricity generated under that Act, are restricted to that base.

This is contrary to the general rule set up by the Supreme Court of the United States in the case of *Smyth* v. *Ames*, and following cases, where it was held that the rate-base was the value of the property *at the time of regulation*. That rule gives the unearned increment to the company and takes it from the consumer. That rule, without any further words, would have imposed the substance of the Conowingo coal clause upon the people of Philadelphia who are to consume the current from that project. The Federal Water Power Act saved the people of Philadelphia from that rule in that case. The Pennsylvania Water Power Act of 1923 has the same effect upon all water powers wholly within the state that are not subject to the Federal act; and a provision, inserted at the instance of the Pennsylvania commissioners in the proposed compact with New Jersey and New York governing the Delaware River, would extend this principle to the 400,000 water horse power that may hereafter be developed in that boundary stream. The Pennsylvania Giant Power bills sought to extend this principle to steam-generated electricity also.

The second reality is that, in the regulation of the security issues of power companies, the par value of the securities shall be equal to this rate-base, this net investment. That is a reality because the people—the consumers—will thereby be saved from deception; they will know what the rate-base is by simply finding out what the securities outstanding are. That rule has practically been in effect in Massachusetts for a generation. Speaking broadly, a public utility in Massachusetts cannot issue securities beyond the net investment. To a certain extent that was written into the Federal Water Power Act.

On the principle of co-operation between Federal and state governments embodied in that Act, it was

provided that the general power of regulating rates, service and security issues was handed over to the state commissions as to power coming from a project developed under Federal license. But if the states neglected the job, if they did not make due provision for the exercise of that power, then and to that extent, the Federal Power Commission was to regulate. This authority had never been exercised until the Governor of Pennsylvania, because the law of this state does not give the Public Service Commission the authority to regulate the issue of securities, appealed to the Federal Power Commission and requested that the securities to be issued in connection with the Conowingo project be regulated by that Commission and be regulated on this principle. The Federal Power Commission took the action requested; so that here, too, the people of Philadelphia, who are to be the consumers, have been saved by this Federal Water Power Act from deception by inflated security issues for the Conowingo project. The proposed Giant Power legislation would have embodied this additional safeguard of the consumer's rights in the law of the state and thus would have made the exercise of Federal authority for their protection against deception unnecessary.

I have space to mention but one more of these realities, namely: A just and stable measure of the "fair return" to which the corporation is entitled by the guaranty of the Constitution. There now prevails a tendency to hit upon some percentage of the rate-base as the measure of a fair return and to apply that percentage in all cases without distinction of time or place. The rate of return tends to become fixed and inflexible as, for example, seven per cent in Pennsylvania. But it is obvious that a rate of return fair in one place or at one time may be unfair in another place or at another time. This inflexibility of the fair return standard pushed many utilities, especially street railways, to and over the edge of bankruptcy in the era of inflation after the war; while many of those which had enough to keep out of trouble then are getting too much now.

This prevailing standard of measuring the fair return robs Peter to pay Paul today and robs Paul to pay Peter tomorrow. Therefore the Pennsylvania Giant Power bills proposed to measure the fairness of the return by its effect in attracting new capital needed for the extension of the company's facilities and service. If the return fixed by the regulating commission is too small to attract that new capital it is unfair to the company. If it is larger than is necessary to attract that new capital it is unfair to the public. Therefore, under normal conditions for a well managed company, the security market gives a daily infallible answer to the question whether any proposed rate of return is or is not "fair." To that standard and to the arbitrament of the security market the American Telephone and Telegraph Company appealed for justification in raising its dividend rate from eight to nine per cent in the period of price inflation and interest inflation after the war. The increase carried the stock from slightly below to slightly above par in the market and so made possible a new stock issue at par for the financing of extensions and improvements.

STATE OR FEDERAL REGULATION?

What says expediency as to the choice of governments, Federal or state, for achieving these realities?

The authority of the Federal Government over water power is quite different from its authority when the power comes from fuel. The movement for Federal regulation of water

power began in 1906 with respect to the water powers in the national forests, and in 1907 with respect to those in navigable rivers. During the controversy there was comparatively little development in navigable rivers, and the development in national forests proceeded under a law authorizing revocable permits. The result was that in this instance the stable door was locked before the horse was stolen, so that seventy-five per cent, more or less, of the water power resources of the country are subject to the Federal Water Power Act.

Where fuel is the source of power, the Federal Government is not a landlord as it is in the case of water power, except with respect to the oil and coal deposits in the Far West. In the East, in Pennsylvania and the northeastern section of the country, coal deposits are in private ownership, and therefore, as sources of power, are under state jurisdiction. The question, therefore, is: How shall the state use its jurisdiction in dealing with the realities I have discussed?

Without attempting to go into it in detail, I will say in passing that in the so-called Giant Power legislation, proposed by Governor Pinchot, the state was attempting to deal with those realities as to electric power developed from fuel on the principles upon which the Federal Government, with the approval of the industry, has dealt with them as to electricity developed from water power.

When it comes to distribution of power as opposed to its generation, we have a field of contact between Federal and state authority in the matter of interstate transmission. Undoubtedly the transmission of electric current over a state border line is interstate commerce. Under the ruling of the courts with respect to other forms of interstate commerce, which we may expect to see applied to this one, some of that commerce may be regulated by the state so long as Congress chooses to do nothing about it, but another part of it cannot be regulated by the state notwithstanding Congress chooses to do nothing about it. If the company which carries the current across the state line itself distributes that current to consumers, then the state may regulate until Congress takes over the job. But if the company which carries it across the state line delivers it to a distributing company in the receiving state, then that transaction cannot be regulated by the state, notwithstanding Congress does nothing about it. As a matter of fact Congress has done nothing about it except in the Federal Water Power Act. In that Act it has said, as to current coming from water power projects licensed under that Act, that the job of regulation is turned over to the states so far as the two states concerned can agree about it and so far as their commissions have authority, but that insofar as they cannot agree about it, or their commissions have no authority, the Federal Power Commission shall regulate. A bill introduced into the Senate by Senator Norris would extend that principle of the Federal Water Power Act to all electric current transmitted across state lines whether generated under Federal license or not. This means chiefly steam-generated current. That is, it would give to the commissions of the states concerned the duty of regulation insofar as they were authorized by their state laws and insofar as they agreed; failing which, the Federal Power Commission should regulate, as it did in the Conowingo case to which I have referred.

PROPOSED SOLUTIONS

Is there any other solution? One has been proposed. Last fall there

was a negotiation entered into by the states of New York, New Jersey and Pennsylvania with a view to an interstate compact for the regulation of interstate commerce in electric power. It was contemplated that if these three states could agree upon a compact, it should be so drawn as to invite the adhesion of other states in the northeastern section of the country; and delegates from other states, including Maryland, Vermont and Massachusetts, attended some of the meetings and took part in the discussions. When it came to the pinch, New York withdrew from the negotiations and they were not renewed. However, the incident is worth mentioning here as an alternative attempted solution of this problem.

The solution was that these states, with the consent of Congress, should set up by compact an interstate commission; that this interstate commission should be given the regulation of commerce among these states in electric power, no matter whether the company carrying it across the line distributed it directly to consumers or sold it at wholesale to a distributing company in the receiving state. It was proposed, however, that each state should have the right to compel the segregation of interstate transmission from the generating and distributing businesses; also that the companies should themselves have the option of making that segregation, so as to limit the jurisdiction of this proposed new interstate commission within the narrowest terms possible.

It was also proposed to deal with the holding company in the following manner. In the first place, no holding company that was not incorporated in one of the states bound by the compact, and no officer, agent or director of such a company, was to be allowed to vote any stock in any operating company in any one of the states. It was proposed that the commission of any one of these states, confronted with the job of regulating an operating company in that state, and confronted with such a contract between the holding company and the operating company affecting the cost of electricity—that the orders of the commission for the production of books and evidence should run into all the states bound by the compact. And thereby the facts, all the facts, could be brought out as to whether it was an equitable contract or not. I merely mention this attempt to use state authority instead of Federal authority in the regulation of interstate commerce in electric power, and the different provisions of the Federal Water Power Act on that subject, as illustrations of the proposition with which I started; that in stressing the difference between state and Federal authority in these matters we are not facing the realities. If we are to deal with the realities we must use both state and Federal authority, and if we fail to use them co-operatively, as expediency may dictate, the realities will escape us.

Federal Versus State Jurisdiction Over Power Development and Its Supervision

By O. C. MERRILL
Executive Secretary, Federal Power Commission

THE question of the development and distribution of electric power is fast becoming one of the most important of our domestic economic problems, second only to that of transportation. The lighting of our homes and streets, and the operation of our industries, our local transportation systems, and to a constantly increasing degree our main line railroads are dependent upon the production, transmission and distribution of electric energy. The volume of electric energy produced and used is increasing with extreme rapidity. A business which is so rapidly expanding creates a host of new questions respecting its management and regulation that demand consideration, if it is to develop with a due regard to the public interest.

Supervision or regulation of power development may be directed to one or both of two phases or stages of the problem: to the physical side, such as the plans of development and the construction and operation of the plant; or to the business side, such as the production, transmission, distribution and sale of the product, and to the financing of the undertaking. For the purposes of this discussion the exercise of governmental control over the physical elements will be called "supervision," and over the business elements, "regulation."

With respect to the physical side, the state and Federal governments have points of contact only where water-power development is involved; for the Federal Government assumes no supervision over any other type of development, and over water-power development only in those cases where lands or other property of the United States are to be used, or where the interests of interstate or foreign commerce or international relations are concerned. Such supervisory authority as the Federal Government has assumed in these circumstances is conferred upon and exercised by the Federal Power Commission under the provisions of the Federal water power act of 1920. Likewise, with respect to the business side, that is, to the regulation of accounting practices and of rates, services and securities, the Federal and state governments at present have contacts in those cases only where projects are built under license of the Federal Power Commission; for under no other circumstances has the Federal Government yet asserted jurisdiction.

Such possibilities of conflicting or overlapping jurisdiction as may exist at the present time between the state and Federal governments respecting either supervision or regulation of power development arise, therefore, wholly out of the administration of the Federal water power act. Under such circumstances it seems desirable to review certain of the provisions of that act and to discuss certain of the administrative policies of the Commission which relate to the subject before us.

FEDERAL SUPERVISORY POWERS

The supervision, which the Federal Power Commission exercises, or may exercise, over water powers which it licenses, covers approval of the gen-

eral scheme of development and of the plans of the physical structures, determination of the time within which the work shall be begun and completed, inspection of construction, requirement of maintenance of plant in full operating efficiency and of the establishment of reserves adequate to make all necessary repairs and renewals, and the adoption of regulations for protection of life, health and property.

While certain of the states such as New York, Wisconsin and West Virginia exercise supervision over all of the items above named, it appears that other states make little or no attempt to do so. In general, those states with administrative water codes governing the appropriation and use of the waters of their streams fix the time for beginning and completing construction as a condition of maintenance of right to the use of water. Some of these states require the approval by a state official of plans of dams in order to give public protection against unsafe structures. A considerable number of states through their boards of health prescribe regulations respecting sanitation in connection with the construction and operation of the power plants. The majority of states through public-utility regulatory statutes make requirements with respect to the establishment of depreciation reserves, but few, if any, appear to exercise jurisdiction over the employment of these reserves for purposes of renewals or replacement other than as the matter may affect findings in a rate-fixing proceeding.

Few of the states appear to have attempted to exercise such supervision over the general scheme of proposed water-power developments as to insure, as the Federal water power act attempts to do,

> that the project adopted . . . shall be such as . . . will be best adapted to a comprehensive scheme of improvement and utilization for the purposes of navigation, of water-power development, and of other beneficial public uses.

In the only instance where a conflict was imminent between the Commission and state authorities over this question, public hearings and the production of new evidence resulted eventually in an agreement being reached. Experience in the administration of the Federal water power act has shown the necessity of the exercise of this authority by some public agency if waste of our water-power resources is to be avoided.

The Federal Power Commission reviews all plans of structures with a view of determining whether they are reasonably well adapted to make effective use of the power available at the site to be developed. It has, in co-operation with state agencies, occasionally passed upon and required revision of plans of dams that appeared to have inadequate margins of safety. When navigation structures are involved, the act requires that the plans shall be subject to the approval of the Chief of Engineers and of the Secretary of War. All construction work in progress in navigable waters is subjected to inspection by the engineers of the War Department. Only rarely, in other cases, has the Commission found conditions such as to make it necessary to have continuous inspection of construction work and in these cases it has requested state agencies either to assume complete responsibility or to co-operate with the Commission.

AVOIDING DEADLOCK POSSIBILITIES

Since the supervisory authority possessed both by the states and by the Federal Government appears to have a sound legal basis, so that the assent or

approval of each is required before a project can proceed, there is possibility of a deadlock between the two authorities. As partial avoidance of such a situation the Federal water power act requires an applicant for a license to present satisfactory evidence of compliance with "the requirements of the laws of the state or states within which the proposed project is to be located with respect to bed and banks and to the appropriation, diversion and use of water for power purposes and with respect to the right to engage in the business of developing, transmitting, and distributing power, and in any other business necessary to effect the purposes of a license under this act." This requirement of the act avoids approval by the Commission of a project which has not the approval of the state. It does not, however, obviate conflict of supervisory authority after the approval and issuance of permit or license. As a matter of practical administration, therefore, conflict can be avoided only by co-operation between the two agencies. Notwithstanding the rapid growth of the power industry and the increase in interstate transactions, the Federal Power Commission considers that power development is still primarily a matter of local or regional interest rather than national, and that, therefore, supervision should as far as practicable be exercised by the states, the Federal Government holding its powers in reserve to aid or supplement the states. This policy of co-operation between state and Federal agencies will, it is believed, make the most effective use of the authorities which both possess.

POWERS OF THE COMMISSION

With respect to regulation of rates, services and securities, or other matters affecting the business aspects of power development, the Federal Power Commission through jurisdiction conferred by the Federal water power act exercises such regulatory authority as the United States has yet asserted in the premises; but it exercises it only with respect to its own licensees, and then, in general, only in absence of authority in the states to exercise such regulation themselves.

The Commission is authorized to prescribe and has prescribed a system of accounting for its licensees. Where, however, there is a system of accounting prescribed by appropriate state authority the licensee is not required to maintain the Commission's system, but merely to submit under the classification of items of the Commission's system of accounts certain reports applicable only to project property. Since the United States has the option at the termination of any license to issue a new license to the original licensee, or to issue a license to a new applicant, or to take over the properties itself; and since if either of the last two options is exercised, the properties must be paid for on the basis of the net investment not to exceed fair value, the maintenance of a standard method of fixed capital recording and reporting is essential.

For similar reasons the approval of the Commission is required for the execution of contracts extending beyond the license period. State interests are recognized by requiring in addition the approval of the appropriate state agencies. The provisions of the law with respect to accounting, reporting, and long term contracts, are primarily for the purpose of protecting the potential interests of the United States in the properties under license. The policies pursued in their administration would appear to obviate any conflict of jurisdiction between the states and the Federal Government.

WHERE STATE JURISDICTION ENDS

In the majority of cases the transactions involved in the production and distribution of power fall wholly within state lines and are, therefore, within the jurisdiction of the state; but, if we may reason from analogous circumstances in cases of interstate delivery of gas as treated in recent Supreme Court decisions, state jurisdiction ceases when the electric energy passes across the state line and the transaction thereupon becomes "interstate commerce." In the Kansas Natural Gas cases [1] the Court said: "The commerce clause of the Constitution, of its own force, restrains the states from imposing direct burdens upon interstate commerce."

Interstate commerce in electric energy may occur under either one of two sets of circumstances. It may consist in the transmission and sale of energy produced in one state and transported and furnished directly to consumers in another state by the company so producing and transporting; or it may consist in the transmission and sale in wholesale quantities to a distributing company, the transporting company possessing no franchise rights for engaging in distribution itself.

It is under the first set of circumstances that the great majority of interstate energy transfers are taking place to-day. They are illustrated in the case of the *Pennsylvania Gas Company* v. *the Public Service Commission of New York*,[2] in which the Court said:

> The thing which the State Commission has undertaken to regulate is local in its nature. . . . This local service is not of that character which requires general and uniform regulation of rates by Congressional action. . . . It may be conceded that the local rates may affect the interstate business of the company. But this fact does not prevent the State from making local regulations of a reasonable character. . . . Until the subject matter is regulated by Congressional action, the exercise of authority conferred by the State upon the Public Service Commission is not violative of the commerce clause of the Federal Constitution.

The second set of circumstances—wholesale interstate transfers—were illustrated in the Kansas Natural Gas cases, and are the circumstances under which, in several cases, important interstate energy exchanges are taking place to-day and will take place to a constantly increasing degree in the future as the limits of our superpower systems are extended and their capacities increased. In the Kansas Gas cases the Supreme Court said:

> The business of supplying, on demand, local consumers is a local business, . . . whether the local distribution be made by the transporting company or by independent distribution companies. . . . But here the sale of gas is in wholesale quantities, not to consumers, but to distributing companies for resale. . . . The transportation, sale, and delivery constitute an unbroken chain, fundamentally interstate from beginning to end, and of such continuity as to amount to an established course of business. The paramount interest is not local but national, admitting of and requiring uniformity of regulation. Such uniformity, even though it be uniformity of governmental non-action, may be highly necessary to preserve equality of opportunity and treatment among the various communities and states concerned.

PROBLEM OF INTERSTATE TRANSMISSION

While no cases involving interstate transmission of electric energy have yet come before the Supreme Court, it is hardly likely that the Court would apply any other rule than it has applied in the cases of interstate transmission of gas. It would appear, therefore, that the Federal Government must assume

[1] 265 U. S. 298; 40 Sup. Ct., 544.
[2] 252 U. S., 23; 40 Sup. Ct., 279.

jurisdiction over these wholesale interstate transfers if they are to be regulated at all. It has been suggested, however, that the court may not have exhausted the alternatives, that the states may accomplish indirectly what they have been forbidden to do directly, or that the exercise of Federal authority may be obviated through a transfer of such authority by congressional enactment to the states.

Since regulation of delivery of energy to consumers by the distributing company under the ruling of the Pennsylvania-New York case may be retained under the authority of the state commissions, it has been suggested that in cases of wholesale purchase where the Commission has no jurisdiction over the wholesaling company, it may ignore the purchase price and fix rates to consumers on what it thinks the price ought to be rather than on what it is. Apart from the fact that the question of whether the distributing company shall or shall not purchase at the price offered is an exercise of a managerial function which the courts are loath to permit the Commissions to exercise on behalf of the utilities, such an act would not be regulation of the character we are justified in expecting to-day. Such a decision by a state commission would not follow upon an orderly summons of the parties and presentation of evidence, for one of the parties would not be within its jurisdiction. In absence of the voluntary acquiescence of the parties a decision of this character could be made effective only through confiscation of the property of the distributing company or through exclusion from the state of the energy previously imported.

It has also been proposed that such a situation could be handled by the states through the medium of interstate compacts which, if approved by Congress, would have the effect of transferring the Federal jurisdiction to the states themselves. If there were only occasional cases of such interstate transfers, or if no transfer affected more than two states, this method might be possible. But the number of cases is constantly increasing, and eventually the transfers will affect groups of states. How readily we may expect any such group to agree upon a common course of action may be judged by the difficulties encountered in the attempt to negotiate the Colorado River Compact where seven states are involved, and the Delaware River Compact where only three are involved. States are naturally jealous of their rights. Being sovereigns they may act only by unanimous consent. If we can imagine a situation in which, for example, the eleven northeastern states comprising the so-called "Super-power Zone" could continue to settle the problems of interstate energy transfers satisfactorily and expeditiously by unanimous consent under the terms of a compact; we would, in effect, have merely created another Federal Government to serve in the place of the one we now have.

The only authority to regulate rates, services and securities of corporations engaged in interstate commerce in electric energy which Congress has yet conferred is that given under the Federal water power act to the Federal Power Commission, and this extends only to authority over the licensees of the Commission, and over them only to the extent that the state agencies have not the authority to act or cannot agree. The Act also gives the Commission, under similar limitations, authority over intrastate operations of its licensees. Since practically all the states have authority to regulate rates and services and the majority of them to regulate securities, the Commission's intrastate jurisdiction, should it

elect to exercise it, would be confined to approval of security issues. It has not acted in any intrastate case, and in only one interstate case, that of the Conowingo project on the Susquehanna River, where the Commission took jurisdiction over the security issues and the interstate contracts because the project was located in two states, and involved wholesale interstate power transmission.

The cases of interstate energy transfers to which the Federal water power act apply, are but a very small part of the cases which exist. These transfers are, however, becoming increasingly more numerous and more important. They will require regulation if the industry is not to get out of hand. The authority to regulate lies in the Federal Government; but to attempt its complete exercise in hundreds of isolated cases scattered all over the United States, through the agency of a commission located in Washington, would involve complications, large expense, and long delays. On the other hand, to confer complete authority on the states would be likely to result in interstate conflicts, or deadlocks. It would appear that the greater part of the disadvantages of complete state or of complete Federal action could be avoided by a combination of the two, by conferring on the states original jurisdiction through joint action of their regulating bodies, and upon the Federal Government appellate jurisdiction. The state bodies, more familiar with local conditions than any Federal body would be likely to be, could hold hearings, take testimony, assemble evidence, and determine the issues. If the states agree and the utility company accepts their findings, such findings should be considered conclusive. If there is not agreement, or if the utility is unwilling to abide by the findings, then and only then would it be necessary to take the case to a Federal agency. Such agency should have appellate jurisdiction only and should render its decisions from the record presented without authority to admit new evidence. A procedure of this character would leave the final authority over interstate commerce in power where it properly belongs in the hands of the Federal Government, would give the states opportunity to settle their own differences, and would avoid the necessity of overloading Federal agencies with details, or with matters that the states had better decide for themselves.

With the powers which the states already possess under the ruling of the Pennsylvania-New York case, and with original jurisdiction conferred upon them by act of Congress in cases of wholesale interstate energy transmission, a situation would be established whereby, without doing violence to our system of government, it should be possible to cover the field effectively and without essential duplication, permitting no twilight zone of uncontrolled operations, but leaving the original responsibility in matters of regulation where it appropriately belongs—in the hands of the several state commissions.

More Government in Business — Does Wall Street Need It, or Main Street Want It?

By Gilbert H. Montague
Of the New York Bar

THE law, as it now stands, makes a sharp distinction between the power that the Federal Government may exert over corporations that have been proved to violate the law, and other corporations which, so far as any proofs or any charges show, have violated no law whatever. The courts have, to the broadest extent, upheld the power of the Federal Government to require the fullest kind of information and the completest disclosure from corporations after they have been proved to have violated the law, or in the course of proceedings against such corporations for violations of law.

How Far Should Government Go?

We are now discussing, however, corporations against which no such charges have been made—corporations that comprise over ninety-nine per cent of American business—and the question we are to consider is the question that Professor Ripley has raised:[1] To what extent, in respect of corporations against which no charges whatever are made, shall the Federal Government exercise detailed control by prescribing what shall be their forms of financial statement?

Professor Ripley's concept of a stockholder, in any of the large corporations listed on the stock exchange, is that such stockholder is an actual or potential voter at stockholder's meetings. Influenced by that concept, Professor Ripley a year ago called attention to what he regarded as dangerous tendencies, under the liberal corporation laws of most of our states, in respect of various kinds of limitations on the voting power of stockholders.

With all respect to the Professor, I think that his concept of the stockholder is very remote from the realities as they exist in any of the large corporations listed on the stock exchange. Very few stockholders, in any of the great corporations of the present day, actually or potentially ever conceive of themselves as voters. You and I are investors. We buy stocks for investment. When we disapprove of the management, we sell the stock. When we have confidence in the management we retain the stock. It is in that act of either selling our stock or continuing to hold our stock, and not at any meeting of stockholders, that we register whatever vote we have.

Because the stockholder is essentially and primarily an investor, the stockholder is of course entitled to the fullest obtainable information about his investment. On this I profoundly agree with Professor Ripley. But the information that will give to the stockholder-investor the information that he needs and is entitled to have does not necessarily have to be conveyed in any stereotype form of corporate report, financial statement, income account, or record of operations.

Anyone familiar with corporations knows that it is just as proper for a corporation consistently to write down its plant, patents and good-will below

[1] See article by Professor Ripley, "Stop, Look and Listen," in the *Atlantic Monthly*, Sept., 1926.

their probable value, as it is for the corporation to attempt every year some form of appraisal by which the corporation may try to place an estimate on the value of those assets. Anyone who has ever tried to estimate the value of such assets knows that no two men can ever agree as to what their value really is at any particular time, and that their value today may be a very different thing from what their value may be six months from now.

To attempt in any serious way any periodical appraisal of such asset values for any of the large industrials of the country would be foolish, wholly misleading, and wasted effort, so far as information to the stockholder is concerned.

The stockholder as an investor is entitled to information regarding his investment, but, as clearly appears from this illustration, that information can just as truly be given to the stockholder by forms of financial statement which, over a period of years, will show whether the corporation is writing down or writing up the value of those assets—in the case of patents and goodwill, whether the corporation conservatively gives no value at all to those items—and which will thus indicate to the stockholder what course the corporation is following in respect to those assets, so that if he wishes he may make his own estimate, which probably will be better for his purpose than having it made by anyone else.

Professor Ripley's assumption, therefore, that the only proper way of giving this information is for the corporation to fill out some stereotyped form of financial statement absolutely misses the realities of the situation.

Starting with the initial fallacy that the information to which the stockholder is entitled can be given in only one way, that is by a stereotype form of financial statement, income account and record of operations, Professor Ripley moves to the next step in his fallacy, which is that since this is not now being done, there should be set up somewhere in the Federal Government some machinery by which corporations should be compelled to do it.

Because some corporations do not give to the public all the details regarding their financial condition that he thinks they should give, Professor Ripley proposes that all corporations engaged in any form of interstate commerce—which means substantially all the corporations of the country, regardless of size and regardless of how their securities are owned—shall annually, or as much oftener as the Federal Trade Commission may prescribe, fill out such forms of financial statement, income accounts and reports of operation, in such detail, and in such manner, as the Federal Trade Commission shall prescribe.

IS INTRUSION WARRANTED?

Is there, at the present time, anything confronting the investors of this country that calls for any such enormous intrusion of government into business, or for the setting up of any such governmental machinery as would be necessary in order to pass upon the details of all corporate accounts of practically all the corporations of this country?

Once more I return to Professor Ripley's article: does "Wall Street"—in which he misleadingly epitomises all corporations—need any such extraordinary intrusion of government in business, or does "Main Street"—by which Professor Ripley means you and me and all the rest of us—really want it?

Several corporations named by Professor Ripley have since proved that if he had more carefully studied their financial statements he would have

found there the details which he claimed were being concealed. Several others could show that if he had ever examined Moody's or Poor's or other standard books of reference, he would have found there the information which he claimed was being withheld. Still others could establish that whenever requested by any responsible stockholder they have always been ready and willing to give additional information on any specific point, and to explain the reason for the form of their published financial statements.

The suggestion, running through Professor Ripley's article, that there is any degree of unresponsiveness on the part of the directors and officers of our great corporations to requests for information coming to them from their stockholders, is absolutely contrary to ordinary experience. No man who has had any experience whatever with the great big corporations of the country can fairly say that there is any indisposition on the part of the officers and directors of the corporations of the country, taking them by and large, to respond to requests for information which may come to them from stockholders.

The degree to which, during the past few years, officers and directors of corporations have become more and more responsive to that kind of request for information is so conspicuous that it is noteworthy, in Professor Ripley's article in which the contrary is suggested, that the Professor has had to go back prior to 1901, twenty-five years ago, to find his best illustrations of any contrary examples.

On the face of it, to use the nomenclature of "Wall Street" and "Main Street" which Professor Ripley has popularized, "Wall Street" plainly does not need, so far as financial statements are concerned, any degree of coercion from the Federal Trade Commission. That leaves this question: Why, in a situation which, if not entirely cured, is already so nearly cured, and can so easily be completely remedied by a plain appeal to educated public opinion and to the sense of fairness of the business community, does Professor Ripley turn his back on these perfectly obvious modes of accomplishing whatever reform is needed, and assume that "Main Street" prefers to accomplish results by means of government paternalism and Federal bureaucracy?

Is there, on the part of "Main Street," any such desire to put the government into business? Professor Ripley assumes that there is, and that the government already has that power. In fact the sensation of his article is his triumphant announcement of his discovery that at the present time there is in the Federal Trade Commission full power to do this, and his comments on the extent to which the Trade Commission has been neglectful of its duty.

Professor Ripley says:

> The Federal Trade Commission Law of 1914 contains in Section 6 a positive delegation of authority to this body which is entirely adequate to the performance of the service so greatly needed at the present time. The Federal Trade Commission, had it chosen to exercise these powers, might since 1914 have gathered and compiled information—to paraphrase the statute—concerning the organization, business and management of any large corporation engaged in commerce, except banks and common carriers.

These statements Professor Ripley makes in his article entitled "Stop, Look, Listen," but if he had ever acted upon his own advice he must certainly have discovered that each of them is absolutely contradicted by the facts. No such powers are, or ever have been, possessed by the Federal Trade Commission.

FEDERAL COURT OPINIONS

Decisions to this effect have been rendered by Federal courts throughout the United States in September, 1919, April, 1920, March, 1922, October, 1922, November, 1922, January, 1923, and September, 1926, and by the Supreme Court of the United States in March, 1924 and March, 1925.

This unbroken line of decisions, each of which was by the unanimous opinion of every judge in each of these courts, has never been challenged by a single decision to the contrary. Heedless of these facts, Professor Ripley chides the Federal Trade Commission for "the neglect of this section of the existing law," which he says is because "the commissioners have been legalistically rather than economically minded," and "since the war, with its concomitant over-development of Federal power, a natural reaction against so-called paternalism supervened."

Each of these reasons, before Professor Ripley ever advanced them, had been officially refuted by judges whose responsiveness to economic thought, whose sympathy with reform, and whose reputation for liberalism, both before and since their appointment to the Supreme Court of the United States, have always been beyond dispute.

"The mere facts of carrying on a commerce not confined within state lines, and of being organized as a corporation, do not make men's affairs public, as those of a railroad now may be," said Mr. Justice Holmes in March, 1924, in an opinion in which every justice in the Supreme Court of the United States concurred.

"Any one who respects the spirit as well as the letter of the Fourth Amendment," continued Mr. Justice Holmes, speaking for the unanimous Supreme Court, "would be loath to believe that Congress intended to authorize one of its subordinate agencies to sweep all our traditions into the fire. . . . We do not discuss the question whether it could do so if it tried, as nothing short of the most explicit language would induce us to attribute to Congress that intent. The interruption of business, the possible revelation of trade secrets and the expense that compliance with the Commission's wholesale demand would cause are the least considerations. . . . We cannot attribute to Congress an intent to defy the Fourth Amendment or even to come so near to doing so as to raise a serious question of constitutional law."

At least two of the judges of the Supreme Court who joined in this decision are economists who, though we seldom think of them as such, are the equals, if not the superiors, of any economists connected with any of our colleges and universities.

PROTECTING FUNDAMENTAL RIGHTS

At this point, it may be expected that somebody will say, "Well, after all, even if Professor Ripley is completely wrong as to the remedy, we must at least give him credit for good intentions, and for calling attention to something that needed to be reformed."

Whether there is anything in the situation that really needs to be reformed is a question to which I have already referred, but even if there is, I inquire whether, as a matter of intellectual integrity, it isn't time to cease this particular form of apology.

If a physician happens to prescribe arsenic, when he ought to have prescribed quinine, it isn't any apology for him to say that at least he knew the patient had a fever.

If an engineer builds a bridge at a place where no foundations are possible, it is no excuse for him to say that at least he favored better transportation.

Economics is indeed a backward science, if the same rudimentary standards of sound knowledge, as well as good intentions, which for generations we have expected from physicians and from engineers, cannot be expected of economists.

The principles that underlie these court decisions to which I have referred are principles that go down to the very foundations of the Republic. Behind these principles, which have been unanimously endorsed by every judge in every court wherever the question has arisen, rests the undoubted concurrence of an overwhelming majority of Americans in every walk of life. If these principles had not been established, one hundred and thirty-seven years ago in the Constitution, they would immediately have to be planted there today, in order to save the states from being swallowed up in an unmanageable, overgrown Federal Government, and to save our fundamental rights to life, liberty and the pursuit of happiness from being obliterated under a sprawling congeries of Federal bureaus.

I don't intend here to urge these principles merely because they are old. I am not invoking the authority of antiquity. I state simply that if, at the present time, these principles had not been applied by these outstanding, forward-looking economists of the Supreme Court, so tremendous is the volume of business that would be brought under Federal control, in the most stereotyped and detailed fashion, that the degree of centralization which would result would break down our form of Federal Government. Taking it simply as a question of administration, it would be impossible in practice to set up any machinery that would work. That is why we are confronted with the question which is the title of my article: "More Business in Government; Does Wall Street Need It, Or Does Main Street Want It?"

TRUSTING PUBLIC OPINION

My sober conviction is that when the people of this country, represented under the collective title of "Main Street," realize exactly what has already been accomplished, simply by an appeal to public opinion and to the sense of fairness of the officers and directors of the great corporations of this country, and how very slight is the need for further reform, and when they realize that in respect of any corporation which is being charged with violation of law, or which has been convicted of violation of law, there is almost no limit to the degree of control which the Federal Government may now exercise over that corporation, they will conclude that, as regards corporations touching every branch of American life, against which no charge of violation of law has ever been made, they can safely assume, for the time being at least, that it is not necessary to set up in Washington any bureau to prescribe the details of every financial statement that those corporations shall put out, and they will conclude, for a while longer at least, to rely upon educated public opinion and the sense of fairness of the business community.

Federal Regulation of Corporations Under the Commerce Clause

By Abram F. Myers
Federal Trade Commissioner

THE constitutional grant of power to Congress was to regulate commerce among the several states, not corporations engaged in such commerce. Corporations are the creatures of the states and the instruments through which commerce, both within and among the states, is transacted. Under the constitutional plan the necessary regulation of the internal affairs of a corporation belongs primarily to the state of its incorporation. The business of a corporation, to the extent that it involves the buying or selling of goods in one state for delivery into another, constitutes interstate commerce. Where interstate commerce begins, and where it leaves off, has been defined with some precision, and its regulation is exclusively the function of the Federal Government. This distinction between the power to regulate a corporation, and the power to regulate its interstate business, is elementary and important; but it is not as rigid in its application as in its definition. Otherwise Federal control of corporations would be legally impossible and there would be no need for this symposium, unless it looked to the further amendment of the Constitution.

Before the adoption of the Constitution there were only twenty-one business corporations within the United States; and of these only two were trading companies and one a manufacturing company. Commerce among the states was a vision, not an actuality. To-day corporations predominate in influence, if not in numbers, in all gainful pursuits save merchandising and personal service. Of the estimated national income of seventy billions in 1923, perhaps thirty-three billions, or say between forty and fifty per cent, was acquired by or through corporations. Practically all of those corporations were engaged in interstate commerce in the sense that they either bought or sold goods in states other than those in which they were located; at least two-thirds were engaged in interstate selling. The amount of their interstate operations may be estimated at around twenty-one billions.

Problem of State-Federal Jurisdiction

Commercial corporations—the kind with which we are now concerned—are created for a single purpose; that is, the transaction of business. Business is the very life of such a corporation; without business, it dies. The connection between a corporation and its business being so vital, it follows that the one may not be regulated wholly without regard to the other. Regulation of interstate commerce, that is the business of a corporation, necessarily implies some measure of control over corporations engaged in such commerce. Obviously there can be no adequate regulation of interstate commerce that does not extend in some degree to the instruments of such commerce. In the case of the railroads, whose business is not only largely interstate but affects directly and materially the interstate business of others, the need for unified national control has been recognized and put in force. So far as the rail-

roads are concerned, Federal control of corporations is an accomplished fact.

Every regulation of interstate commerce by the Federal Government involves the occupation of a jurisdiction, or the exercise of a function, formerly belonging to or exercised by the states. The courts, therefore, have been extremely cautious about laying down general principles dealing with the powers of Congress under the commerce clause. Since the adoption of the Constitution great progress has been made in the direction of a unified national control of the nation's business. This advance, however, has been neither steady nor unopposed. It has been accelerated or retarded, depending upon the existing state of public opinion. The boundary line between the jurisdictional spheres of the state and Federal governments is elastic, not rigid; ragged, not straight. The courts, while deciding cases on the law and evidence, have not been unmindful of the state of public opinion in difficult cases.

Much as we would like to regard the law as an exact science, we can only speculate as to how far the courts will indulge Congress in efforts to control industrial corporations by sporadic acts not imposed as conditions to the right to engage in interstate commerce. The power to control corporations through publicity—a method recommended by the Industrial Commission and attempted to be carried out through the Bureau of Corporations and the Federal Trade Commission—still remains in doubt. The Supreme Court, after three years of deliberation, finds itself unable to decide whether the Federal Trade Commission has the power to compel the furnishing of reports concerning costs and profits. Recent decisions relating to the Commission hold that, before its inquisitorial powers may be exerted, there must be a finding, or at least a specific charge, of a violation of some Federal law on the part of the corporations to be investigated. These decisions reject the view that the preventive or prophylactic effects of publicity may serve as a justification for the exercise of inquisitorial powers. There is a growing tendency on the part of the courts to brand all investigations as fishing expeditions unless it appears that the fish are already caught.

This, however, is but a natural manifestation of the policy of our law, derived from the common law, and has for its purpose the protection of the individual against unnecessary governmental molestation. The theory is that governmental interference in business comes as a penalty for an infraction of the law. It is punitive, not preventive; it has to do with locking the stable after the larceny is committed. While the courts strain over the power to obtain information from industrial corporations (except under procedures established for the protection of persons accused of crime), they do not hesitate to exert the most drastic measures of control over such corporations once they have been adjudged guilty of some purely statutory offense. According to the prevailing view the government may not intrude upon the privacy of a corporation to ascertain whether it is obeying the law or whether additional laws are necessary for the protection of the public. But as soon as a violation of the law is established, the corporation becomes subject to the full power of the nation and the privileges and immunities conferred by the state avail it nothing. Thus corporations adjudged in violation of the Sherman Antitrust Law may suffer their charters to be rendered useless and even canceled; their mortgages to be rewritten; and their properties to be divided and sold. These are measures of direct control equal to any which may be exerted by the state under

whose laws the company was incorporated.

The time is approaching when the country will be confronted with Federal control of corporations as an inescapable issue. The statutes now on the books, for the most part, have to do with the regulation of the business of corporations, rather than with the control of the corporations themselves. Such statutes were more nearly adequate to the protection of the public in the days when the ownership of corporations was confined to a few powerful families or groups, than they are to-day. The great corporations to-day are with few exceptions owned by thousands of stockholders, big and little; and their securities are held in every state. The protection of the competitor of a corporation and the consumer of its products is still a matter of grave concern; the protection of the investor is becoming quite as important. Diffusion in the ownership of corporate securities, more than any other recent development, makes Federal control an issue—perhaps a necessity.

Public opinion will not much longer tolerate a condition under which a few states vie with one another in creating corporations with unlimited capital and powers, without requirement that they engage in business in the states of their incorporation, and without provisions looking to the disclosure of their operations or accounts, to transact business and market their securities in other states. An effort has been made to justify these loose incorporation laws on the ground that they encourage the development of industry within the states; but the effort fails in view of the omission of any provision that the corporations shall conduct their operations in whole or in part within the states of their incorporation. The inference is irresistible that the incorporation of companies is solicited by these states because of the license fees and other revenue derived from the business. The creation of corporations has lost its dignity as an exercise of the sovereign prerogative for the furtherance of commerce and in the interest of the people of the state. What was once regarded as the conferring of a great privilege, to be limited and circumscribed by all necessary provisions for the protection of the public, has become a bargain sale, and states are advertising and competing for the business.

But even though, as is widely believed, there is an urgent need for Federal control of corporations, extension of the powers of the Federal Government to that subject will meet with stubborn opposition. The consistent opponents of centralized government will repeat their time-honored, but generally disregarded, argument that the further extension of Federal power will impair, possibly destroy, our dual form of government. States' rights, by no means a forgotten slogan, will be revived. It will be contended that the proposal will further centralize power in administrative bodies remote from popular control. Finally, the still more appealing objection will be raised that the proposal necessarily involves an increase in the existing over-supply of bureaus and bureaucrats—a disadvantage thought to outweigh all possible benefits.

FEDERAL INCORPORATION

The proponents of Federal control, on the other hand, are fortified with arguments that have carried them to victory in many bitter contests. Does not the Constitution contemplate that the powers of the Federal Government shall extend to every matter that concerns the whole people, and in which the states are incompetent or unwilling

to act? Can it be that between the powers of the state and Federal governments there exists an air pocket which leaves the citizens of a majority of the states without proper protection from the action or inaction of a few states? And is not Federal control made necessary by the practice of a small number of states in spawning corporations with unlimited powers to transact business and market their highly speculative securities in all of the states?

If reform could be had without the further extension of Federal power, all would rejoice. The adoption by the states of a uniform and enlightened policy in chartering and dealing with corporations would afford a remedy more in keeping with our dual system of government. Self-correction on the part of the corporations also could constitute, if not a complete solution, at least a great step forward. But one must indeed be an optimist to expect action from those quarters. The self-interest that leads to the adoption of the methods complained of, would preclude their voluntary relinquishment. Possibly national prohibition could have been avoided by the observance of a certain degree of self-restraint by those engaged in the liquor traffic. But self-interest is a barrier to self-reformation, and we may not hope for any useful results from state legislation or voluntary corporate action.

Coming to a consideration of the courses open to the Federal Government, the first choice is between the exertion of a direct and immediate control over the corporation itself, and the exertion of an indirect control by means of publicity. In the present state of the decisions, we can hardly expect that measures of the first class will be sustained unless Congress boldly announces that it intends to occupy the entire field of regulation so far as it relates to interstate commerce, with all its incidents. Nothing short of a Federal incorporation law for all concerns engaged in interstate commerce could achieve that result. If the exertion of such measure of control is the aim of the present agitation for Federal control of corporations, then let us hope for a revival of the discussions of the last quarter of a century concerning Federal incorporation.

While Federal incorporation would vest in the national government full and direct control over corporations engaged in interstate commerce, it would have the added virtue of protecting the corporations against restrictive and discriminatory legislation by the states. The most impressive arguments that have been made in favor of a Federal incorporation law, have been urged from the standpoint of the corporations. Theoretically a corporation chartered in one state is a foreigner in the forty-seven other states, and enters those states, and remains in them for the transaction of business wholly by sufferance, and (within limits) subject to the conditions and limitations that those states, acting individually and from the standpoint of their selfish interests, see fit to impose. While in practice the attitude of the states towards the corporations of other states has been modified by considerations of comity and tolerance, it is nevertheless true that insofar as interstate commerce is concerned, one state authorizes business concerns which every other state has the right to restrict or even to destroy.

As already pointed out, the Federal Government may utterly dismember a corporation that has been adjudged in violation of the Sherman Antitrust Law. But why should the Federal Government withhold its hand until a combination has been formed under state law? Would it not be better for the Federal Government to say in the

beginning what shall be the nature of the organization that may be permitted to engage in interstate commerce? Federal incorporation would vest in the government a degree of control over corporations that would amply protect the public interest, without the necessity for long and expensive litigation; and would enable the business of the nation to be conducted with a degree of certainty and stability that would more than compensate for the disadvantages inherent in the extension of Federal authority.

GRANTING OF FEDERAL LICENSES

Indirect control of corporations, by publicity of their accounts and affairs, as well as many of the objects that could be attained by Federal incorporation, may be accomplished by a system of Federal licenses. Measures for Federal license, and for Federal incorporation, have gone hand in hand into and sometimes through the committees of Congress; and their respective merits and demerits have been many times discussed. Federal licenses for corporations engaged in interstate commerce have been favored by many on the ground that the enactment of such a measure would avoid many of the serious questions relating to state taxation and state police power that would be inherent in any provision for Federal incorporation. As a means of insuring publicity of corporate affairs, a Federal license law would be entirely effective.

Such a law would provide that no corporation should engage in interstate commerce without first obtaining a license from the Federal Government. Such licenses would be issued by an appropriate government agency, preferably the Federal Trade Commission, and would be conditioned upon compliance by the corporation with the conditions enumerated therein. A condition of the license would be that the corporations should file with the issuing body annual reports of their operations, including balance sheets and income statements. The corporations would be classified; and for those corporations in which the public interest required it, particularly for the benefit of investors, the reports, or appropriate parts thereof, would be made a public record and also currently published. For the more important corporations, including representative concerns in the chief branches of industry, quarterly income statements would also be required sufficient to show the volume of business and net operating income, for the purpose of disclosing the trend of business during the year. For all corporations reporting, the information would be compiled and published promptly in unidentified form for the purpose of guiding business development and promoting business stability.

The need of comprehensive statistical information, for the intelligent conduct of business, is recognized by all who are conversant with the subject, and it is the professed purpose of the current organizations of all branches of business into trade associations. The end to be served by having such information, namely, the more intelligent direction of business operations based on better knowledge of supply and demand conditions and on the profitableness of business in different branches as indicative of overdevelopment, or the contrary, is obviously of such great public concern that the government should itself collect, compile and promptly publish, as a general clearing house, the fundamental and essential facts.

UP TO CONGRESS

The problem is primarily for Congress, and must be faced squarely, if at all. The fundamental question is:

Will the public interest be better served by the preservation of the historic division of powers between the state and Federal governments, or by a unified national control of business? The proposal to extend the power of the Federal Government to corporations chartered by the states should not be undertaken without full appreciation that it involves a departure from long cherished constitutional concepts. The measures to be adopted must be plain and should clearly express their true scope and meaning. Decisions adverse to governmental authority have sometimes resulted from the fact that it was being attempted to give an effect to statutes not in the contemplation of Congress at the time of their enactment. Legislatures are too fond of enacting ill-drawn statutes and holding administrative officers and the courts to strict accountability for their enforcement. The exertion of Federal power over state corporations is too important an issue to be submitted to judicial determination upon a forced construction, or even a literal application of a statute not specially designed to that end. Not only should the measures express their true scope and meaning, but they should be based on congressional findings of specific evils to be remedied.

Once the problem has been fairly met, and clear measures based on adequate findings have been adopted, I believe that the power of Congress to enact such measures will be upheld by the courts. Courts in giving effect to an act of Congress are fortified by a realization, derived from the proceedings attending its passage, that they are executing the will of the people. In the decision sustaining the Grain Future Act[1] we have an example of the importance that the Supreme Court attaches to congressional findings as to the need for particular legislation in upholding the power of Congress to enact it. Administrative officers, seeking to act under statutes of doubtful application are often turned back, not because the courts believe the Federal Government impotent to empower the officers to perform such acts, but because the officers do not exhibit clear credentials from the legislative branch, the source of their authority.

And so I repeat, once Congress has decided to exert its full powers in this direction, the Constitution will be found to be a facility, not an obstacle, in the harmonious adjustment of the powers of the state and Federal governments to the end that proper and necessary regulations may be provided for the protection, the prosperity and the convenience of the whole people.

[1] *Board of Trade* v. *Olsen*, 262 U. S. 1.

State Regulation of Corporations by Policing Sales of Securities

By Hon. Keyes Winter
Deputy Attorney-General of the State of New York

THE subject under discussion, "Federal Control of Corporations," is as broad as the multifarious activities of the people of this widely diversified country of ours. I propose to limit myself to the subject of the regulation of corporations by policing the sales of their securities.

On general principles, I am opposed to the wholesale surrender by the citizens of the several states of their control over their business, and I am opposed to the alarming tendency fast becoming prevalent of assigning their minute and intimate affairs to the Federal Government at Washington for regulation.

Our dual form of government was established on the wise theory that the citizens of the several states retained the full and complete government over their own affairs. In forming a Federal Government they delegated to it only certain limited powers relating chiefly to transactions with foreign nationals, transactions in commerce between the states, the postal service and other interstate matters, all of which is defined in the Constitution of the United States.

It was the spirit of our government then, and the spirit of our government now, an inheritance from our Anglo-Saxon origin, that the individual citizen shall regulate his own affairs with the least government possible; and that such governmental control as is found necessary shall be primarily local and extend from the locality to the state only where the common interest requires the application of broader rules.

The problem that confronts us here is not so much the expediency of Federal regulation of your or my business, but it is essentially the power and the ability of your state to properly regulate that business. The question is, has the authority of the several states collapsed over the corporate Frankensteins that they have created? This question I propose to answer in my remarks that follow.

A corporation is merely a form under which natural or individual persons transact their affairs. Like "Christmas spirit," it has no physical existence. It is what the philosophers call an idea. To us lawyers it is a contract between the state and a group of individuals with certain reservations, whereby these individuals and their successors may transact their joint affairs with certain privileges and liabilities that as individuals they do not have. Beyond a charter filed in a public office, nothing material is created, but the group thereupon take on certain relations among themselves and toward the public. This conception of a relationship is a corporation.

Creatures of the several states, these privileges and relations may be modified or regulated by their creators. Thus the right to succession, or the right to transfer the shares of corporations, may be regulated or even forbidden by the states.

The members of these groups are "stockholders." While in most instances these groups are composed of citizens of different states, yet their corporate privileges are valid only by

virtue of the laws of the state of their incorporation.

Originally corporations were composed for the most part of small groups of business friends, associated in a common enterprise, each with a substantial interest. There are now, of course, many such. But in modern times stockholders constitute relatively enormous groups of the citizens of this country. The stockholders of some of our large corporations number many thousands, most of them owning but few shares. The United States Steel Corporation is a group of over 160,000 stockholders; the Pennsylvania Railroad, of over 140,000; the American Telephone and Telegraph Company, of over 366,000. Their personnel is constantly shifting, as these stockholders buy and sell out of the corporation. Hundreds of thousands of shares of United States Steel are bought and sold daily on the New York Stock Exchange. The transactions in shares of other corporations are almost equally as large. Hundreds of thousands of shares are bought on margin and the owner's name seldom appears on the books of the corporation. A large portion of these stockholders are women and people of small means with no business experience. More and more of the employes of corporations are becoming shareholders of their employers on partial payment plans, and some of these plans require the return of the stock when the employment ceases. The purpose of the scheme is to tie the employe to the business.

SEEKING A CURE

It is probably agreed on all sides that they need protection and need it badly, not only from the schemes and manipulations of wicked promoters, but also from their own cupidity. But where we doctors disagree is about the method of protection and the degree.

To approach the problem on the mob rule theory that this uninformed and undiscriminating mass of speculators can be equipped by publicity to regulate for themselves the intricate details of corporate business will certainly get us nowhere.

Recently a distinguished economist in the September issue of the *Atlantic Monthly* has most persuasively voiced a call for publicity of corporate transactions. He criticizes the meagerness of the usual annual report and then suggests as a remedy that the Federal Trade Commission be goaded into a general excursion into the books of all the corporations of this United States and divulge the results to the public.

This cry for publicity was made in the interest of present and of prospective stockholders. Now, let us inquire how such proposed publicity may benefit the stockholders, either actual or prospective. Does it secure a more economical management of the affairs of the corporation, or does it primarily enable investors to select, buy and sell shares in corporations to their advantage?

It is estimated that about 20,000,000 investors live in the United States. The vast proportion of this 20,000,000 are minority stockholders scattered from Maine to California. The individual voice of the greater portion of them appears so feeble and their inability to grasp the intricate and technical details of their business is so manifest that they wisely prefer to leave the helm in the hands of others, contenting themselves with the quotations of their stock on the public markets. Few of them attend corporate meetings. Hence, the actual management of their corporations is actually in the hands of one or two individuals who can and do perpetuate their own control, their own employes and their own policies by assembling proxies of

fifty-one per cent of the stock in advance of meetings. So we find, particularly in our large corporations, that the responsible heads are placed there and are dominated by a few owners of the larger blocks of the stock, but nevertheless minority blocks. Although theoretically the vote of this enormous mass of stockholders may control bad management, practically a disgruntled minority stockholder's sole remedy against bad management is to sell his stock, take his loss, and reinvest the proceeds in other stock which he believes may be more fortunate.

It seems fairly obvious that the outcry for publicity has no direct relation to any cure for mismanagement of corporate affairs.

On the other hand, the public ventilation and exposure of the affairs of corporations tends to restrict fraudulent, unjust and unfair practices in the issue and marketing of their securities and enables investors to select, buy and sell with full knowledge of the facts.

In the last analysis, fraud is effected either by positive mis-statements or by concealments of facts. In the issue and sales of securities most frauds are accomplished by cunning innuendo and by concealments of fact. Investors buy and sell securities on cleverly circulated rumors, tips and hunches, and usually in complete ignorance of what they are buying and selling. Thus, the whole subject of disclosures by corporations of their affairs is closely related to the prevention of frauds upon stockholders, and inasmuch as the interest of the average stockholder is identified with the market for his stock, it follows that the state, by policing sales of stocks and by the enactment of laws for that purpose, may provide a full measure of protection to stockholders where it is vital. And this I hold is a proper function of government.

Again, I believe, and I assert it without fear of contradiction here, that government interference with the management of private business is not a cure. I am aware of the fact that the socialist thinks otherwise. My own experience in government operation has been disastrous. Frequent complaints are made to us against corporations whose business is conducted unwisely, where no dividends are being earned and particularly where the market price of the stock has collapsed. In one corporation we found that the moving spirit was a visionary inventor who was conducting the corporate affairs more to the end of developing a toy than to the production of dividends. In that case we interfered and compelled the inventor, a man with an international reputation, to eliminate himself from the management and install a voting trust controlled by the minority stock of the corporation. The stockholders responded by saddling the entire business on our office.

PASSAGE OF BLUE SKY LAWS

Forty-five states of the Union have passed blue sky laws regulating the sales of shares of corporations to the public. The dominant feature of all these laws is the grant of full powers to the several Security Commissioners to discover the condition of corporations selling stock or whose stock has been sold in these states.

With the exception of Delaware and Nevada every state in the Union has thus installed machinery to expose fraudulent, inequitable, unjust and unfair practices, not only in the sales of corporate shares in such states, but also from them.

Now, let us see whether these statutes are designed to protect stockholders and if they are administered with that effect.

The state blue sky laws do not

primarily regulate the management of corporate business, but they are designed to prevent the sale of corporate securities whenever fraudulent, unfair and unjust practices are discovered. They are all substantially uniform in that they all require corporations and individuals to give full information of their affairs to the state for that purpose.

Forty-three of these states prohibit any sales of securities in their states, and thereby exclude their citizens from owning shares in corporations unless these corporations are previously licensed. The burden is placed on the corporations to show a clean bill of health. New York, Maryland and New Jersey, on the other hand, differ from the other forty-three states in that respect. New York, Maryland and New Jersey freely permit unrestricted sales of shares of corporations until fraud or unfair and unjust practices are discovered, in which event the investment may be prohibited. The burden of proof is here placed on the state of discovering unhealthy conditions. Forty-three states have licensing laws. Those of New York, New Jersey and Maryland are known as investigation and injunction laws.

The effectiveness of blue sky laws depends absolutely on the vigilance, energy and intelligence of their administrators. A weak law, wisely and energetically administered, is far more effective than a strong law that is feebly enforced or not enforced at all.

In all state blue sky laws the teeth lie in the provisions for a discovery of facts, a compulsory and supervised discovery. Subpœna powers are granted the Security Commissioners with heavy penalties for perjury and disobedience, and where the provisions are enforced and are publicly known to be enforced, only corporations which can present a good balance sheet and only promoters whose records are presentable seek capital within these states. Let me demonstrate how in New York the provisions for discovery of themselves have served to protect stock-holders.

THE MARTIN ACT OF NEW YORK

The City of New York is perhaps the financial capital of the world. Over 5000 corporations a month are organized in the State of New York. On some days over three million shares of stocks are traded in on the New York Stock Exchange. There are approximately five thousand dealers in securities registered in my state. Almost every large corporation in the country has its main office there. Thousands of corporations locate their transfer offices there. Billions of dollars are loaned by the banks of New York on collateral consisting of corporate shares. The business of this entire nation is inextricably interwoven with the purchasing and selling and transfer of corporate securities in the City of New York.

A license law restricting these transfers of securities in New York State preliminary to a thorough investigation would choke business, not only in the state, but in the entire United States.

The Martin Act permits the free sale of any stocks or securities in the State of New York provided they are sold without any misrepresentation or concealment of their real nature. On the other hand, no security can be safely sold under the provisions of this act if its character is in any way misrepresented.

It has been estimated that over $1,700,000,000 is taken from the public annually by stock swindles. If this estimate includes fraudulent promotions, watered stock, wash sales on rigged stock markets, fraudulent re-

organizations, bonds secured by mortgages on over-appraised real estate, bucket shop operations and other forms of frenzied finance, then I say the estimate is over-modest.

Over three-fourths of this loot, I venture to say, has been taken by transactions conducted in whole or part from the State of New York. The result of this is that to the average rural American "Wall Street" is synonymous with fraud and unjust and inequitable practices. Yet the proportion of unfair practices to the enormous volume of honest transactions is small.

Nevertheless, the fact remains that frauds and unfair and inequitable practices in the sales of stock in the State of New York were a public scandal and have earned the deep and abiding resentment of the public. Brokers and banking houses of at least respectable appearance have unloaded stock on the public at fancy prices based on inflated inventories, retaining enormous promotion profits secreted in items of good-will, patents and inventories. Manipulations of these stocks on the stock exchanges by means of pools, washing the sales back and forth at rising prices, have lured the public into purchases in the belief that large profits would follow. Bucket shops equipped with stock tickers, boards and mahogany furniture nested among the respectable addresses in every office building and reaped their harvest among the small wage-earners, encouraging gambling and speculation. Fallow mines and visionary oil wells bought for a song were capitalized at millions and sold by ex-convicts through apparently unbiased "tipster" papers which were in reality owned by the promoter. The entire mechanics of frenzied finance was in full operation.

The Martin Act is New York State's substitute for a blue sky law. As I said before, it is not a license law. It gives the Attorney-General of the state power to issue subpœnas and examine under oath any corporation or individual and command the production of any book or paper. The scope of this examination is limited to practices in the sales of securities. Obviously, any matter, however, that relates to the business of the corporation, its management, its property, is material in uncovering innuendo, concealment and fraud. Such practices as are found to be fraudulent, unjust and inequitable may be enjoined by our Supreme Court in a suit by the Attorney-General.

These injunctions do not absolutely prohibit sales of the offending stock. But as a condition of continuing they require corporations and promoters to make full disclosure of all facts and discontinue mis-statements and misrepresentations of facts. They require brokers to reveal their interest in these transactions and disclose secret profits and to actually buy and keep on hand their customers' stocks. In other words, these injunctions in the main force publicity of facts and true conditions on the theory that the investor or speculator is the person most competent to buy without the advice of the state. Also the injunctions move against the individual actors, bringing home to them as individuals the moral and legal responsibility for the corporate delinquency.

The teeth of this statute is the power in the Attorney-General to compel full and prompt disclosure of corporations' affairs.

The Martin Act was originally enacted in 1921 following the public outcry against the bucket-shop scandals of Wall Street. The criminal laws as a remedy had completely collapsed, due to the difficulty of obtaining evidence, and the necessity of proving the offense within its strict statutory definition.

Define fraud and you advise the swindler how to circumvent.

RESULTS OF ENFORCEMENT

However, until 1923 there was no appropriation for the enforcement of the Martin Act. And from that date until January 1, 1925, it was but feebly administered.

Commencing with January, 1925, however, the present Attorney-General of the State of New York, Albert Ottinger, obtained an appropriation from the Legislature of $100,000 and commenced a vigorous enforcement of this law. Questionnaires demanding complete information were broadcasted, not only to corporations organized in this state, but to corporations with offices out of the state. In two years over ten thousand witnesses were examined about the most confidential and diverse affairs of numerous corporations, banks, investment trusts, stock exchanges and brokerage houses. Attorney-General Ottinger has not hesitated to place under his subpœna the employes and officers of the large public utility corporations, the city departments, the New York stock exchanges, the Federal Reserve Bank, the large real estate bond and mortgage companies, and many of the large stock exchange houses in the city. Proceeding on the theory that corporations are but cloaks under which individuals act, we have invariably ignored the corporation and probed the actors.

The result of this general inquisition has been apparent. A general housecleaning has ensued in the State of New York and an exodus of undesirables to Florida, Boston, Canada and New Jersey.

Our bucket shops which have heretofore flourished like the bay tree have been almost completely eliminated. One large stock exchange and three or four small ones, and several commodity exchanges have been either closed or effectively regulated. Herds of confidence men, working through the rural districts, have been run out of the state. The "Roaring Forties" (our Great White Way) are no longer distinguished by crowds of high pressure stock salesmen. Unfair and unhealthy conditions in the real estate bond and mortgage houses are in process of voluntary correction. Several large reorganizations have been supervised. The district attorneys and the police are constantly referring complaints to us. Yet, with all our examinations, the number of injunctions we have obtained have been relatively small, not over two hundred and fifty.

From my observation this change of condition was brought about by our power to examine and discover. The ever-present threat of thorough ventilation, coupled with the announced determination of Attorney-General Ottinger to enforce the statute, has been a preventive just as effective as any actual injunctions to cease and desist.

It is my observation that the average person is a law-abiding citizen. Any law that appeals to his conscience and has the backing of public opinion will be obeyed generally without any particular threat of punishment. But a law that has no appeal to the conscience of the average man and is not backed by public opinion will meet public resistance no matter how severe the penalties.

A law merely designed to investigate corporations and publish information to satisfy public curiosity, even if constitutional, is odious. But any law that has for its object the prevention of frauds upon the public will obtain, and has always obtained, the full measure of public support, and it is that support that enables government to enforce the law. The Martin Fraud Act is such a law. It has the full public support and it is accomplishing its purpose.

NATIONAL ASSOCIATION OF SECURITY COMMISSIONERS

Frauds and unjust and inequitable practices in the sale of securities are not only intrastate, but they are often interstate. Thus, at the present time we have found a promoter or stock manipulator of a particularly evil reputation publishing and circulating a paper from the City of New York, a so-called tipster paper, in which the subscribers are brazenly advised to buy the stock of a copper mine in Idaho. Over 600,000 of these papers are mailed from New York City to subscribers all over the United States. The mine in Idaho is fallow and cost the promoter less than $10,000. Its stock is listed on the Boston curb market, where the prices have been washed from 50 cents to $5.00, giving the mine a capitalization of over $15,000,000. To expose this fraud investigations are required in three states, New York, Idaho and Massachusetts.

To meet situations like this the Security Commissioners of the several states have voluntarily organized a National Association of Security Commissioners, supported by appropriations from each of the member states. This association holds an annual convention and there formulates a policy of uniform principles and procedure, suggests legislation and considers mutual problems. A president and secretary are elected. During the year monthly bulletins are distributed of the proceedings pending before each Commissioner. The fullest co-operation is secured among the members and each is thereby provided with the machinery of the entire group of forty-five sovereign states, and of forty-five experienced and capable executives.

In actual practice the utmost harmony and co-operation is afforded by this association. Each learns by the experience of the other. Local problems are treated locally, while national and interstate problems are treated broadly. In the example I have just given, the State of Idaho is presenting me with full information and evidence of the Idaho mine, and the State of Massachusetts of the manipulations on the Boston Curb Market. New York is maintaining proceedings against the promoter to stop the fraud.

Thus it seems to me that the control of corporations which are, after all, merely groups of the citizens of the several states endowed with certain privileges, may be safely left to the states that created these privileges, and that this control is more properly exercised by policing sales of securities than by state or stockholders' interference with management. Perhaps in some instances the frauds are not exposed and corrected with the vigor expected by the public, but that, it seems to me, is the fault of administration rather than with the laws.

And as New York State is the source of a greater part of the public resentment, the responsibility is put up to the Attorney-General of that great state. As his deputy, charged by Mr. Ottinger with the responsibility of enforcing that law, I therefore say, he assumes that great responsibility, we have no alibis to offer, the law is entirely adequate with slight amendments, and we propose to enforce it to the limit, to the end that fraudulent and unjust and unfair practices in stocks shall discontinue. This includes the operations of any individuals whether done singly or with others, and whether done under the cloak of a corporation, partnership, stock exchange, investment trust, bank or any form of human organization. And in expressing myself thus, I do so with the conviction that we have the organized backing and co-operation of forty-five states of this nation.

Book Department

WHITE, LEONARD D. PH.D., Professor of Political Science. University of Chicago, *Public Administration*, p. ix, 495, New York: The Macmillan Company, 1926.

This book presents a general picture of the organization, structure, methods of activity and personnel of the executive branch of government. The author disclaims any intention to describe special departments of administration nor does he seek to cover the administrative law of state or nation.

The book is intended rather to present a series of problems which arise in nearly all public administrative work and to sketch some of the answers to these problems without dogmatic statement as to the merits of any. These reservations necessarily make the book a general one so that it is appropriately called an Introduction. There are several chapters on the importance and relation of administration to law-making and to the courts. The problem of centralization is considered. The structure of administrative departments and the movement to integrate the administration, that is, to bring its various isolated parts together into a comprehensive, responsible unity,—all these are stated as problems and their significance is clearly set forth.

Special attention is given to the question of personnel. Two-fifths of the volume are devoted to this topic, covering the historical background, the problem of morale in the civil service, the methods of recruiting, the classification of employes and their salaries, efficiency records and promotion, discipline and removal, pension systems and unions of public employes. The book closes with a chapter on trends of modern administration which should be read by every student in political science.

In the following interesting paragraphs, the author sets forth the substance of the preceding chapters: "These, then, are the main lines of development: the steady growth of the merit system with its implications of permanent employment and the provisions of a career, the constant limitation of the unregulated authority of the local area, the rise of the principle of administrative supervision and unified leadership, the emergence of the specialist and the expert, the origin of significant economic and professional organizations of public employes, and the rise of scientific inquiry into problems of government and administration. Each of these movements seems likely to project itself into the future for decades yet to come."

The author's style is clear and interesting. The choice of material is excellent and while there may be differences of opinion as to the proportions of the various topics, the general field is well covered.

In a volume of this size, intended only as an Introduction, one must not expect an intensive study of problems requiring long continued research. The author has held to his plan of stating rather than solving questions. An example is his discussion of the growing centralization of our system. Professor White points out that "the rise and fall of the local area as the pivot of our administrative system runs through most of our history. The process is almost universal, but is proceeding at different rates of speed in different parts of the country. . . . On a national scale the march toward Washington, which goes on without interruption, is now stirring lively protests on behalf of state rights. . . . The economic interpenetration of one part of the country with another, the amazing mobility of the population, the community of interest on a national scale in such matters as highways, health, labor supply, taxation, education, methods of communication, as well as the older communities of interest in such matters as foreign affairs, the army and the navy, demand political and administrative organization to correspond with national needs."

As centralization increases and as administrative work becomes more complex, scientific and expert in nature—"how can a working connection be maintained between the official and the public? Lacking such a connection, the danger of mutual misunderstanding and misconception is great."

One could wish that the author had written a full chapter here.

This problem which has been envisaged by many publicists is probably the greatest single question confronting the student of public administration to-day. The lack of contact between the public and the administration is even more serious than the absence of such contact between the lawmaker and the public.

Can good administration be popularized or must it always have that flavor of Prussianism which our people so strongly resent? Can we make the administration of the law thorough and scientific and yet retain its human responsiveness and popular sympathy?

There is urgent need of a whole series of scientific studies in this field of relations between Government and public. Some inquiries are already being prosecuted to ascertain the most feasible methods of maintaining contact between administrative bodies and business organizations, but the field as a whole is undeveloped and urgently calls for attention.

Other problems which perhaps deserve more space than has been allotted to them are the administration of business enterprises operated by Government, the participation of administrators in law-making, the possibilities of decentralizing Federal administration, etc.

It may be hoped that the book will see several editions and that it will be expanded to cover with greater fullness some of these important subjects.

JAMES T. YOUNG.

National Municipal League. *The Merit System in Government*, Pp. 170. New York: published by the National Municipal League, 1926.

This report was worked out during 1924 and 1925 by a conference committee representing the National Municipal League, the Governmental Research Conference, the National Civil Service Reform League, the National Assembly of Civil Service Commissions and the Bureau of Public Personnel Administration, and it is intended merely to give a definite statement of the functions which a public personnel agency should exercise and of the results which should be expected from their adequate performance.

This restricted object limits the usefulness of the book, which is still further diminished by differences of view among the members of the committee on some of the larger issues, notably on the preferred type of organization of the personnel agency. Here the committee limited itself to a bare statement of four possible types with arguments for and against each. May it not be, in view of the fact that such a distinguished committee failed to agree at this point, that something can be said for different types, any one of which may give reasonably good results? Put in other words, has not too much emphasis been placed in recent years on the form of organization and too little on the technique of the personnel agency?

Much of the subject matter of the volume has appeared in other sources. The committee worked without research assistance and was unable to conduct field studies to clarify points of disagreement. This must remain a source of regret to those who hoped to find new light on the problems involved.

The book has nevertheless the distinct merit of presenting a simple statement of current thought about the elements of public personnel administration and of offering a model civil service law (appendix 3). In view of the host of pressing problems which center about the subject, it must be a matter of regret that the committee limited itself to a task which perhaps inevitably remains sufficiently barren.

LEONARD D. WHITE.

HUNTER, MERLIN H. *Outlines of Public Finance*. Revised and Enlarged Edition. Pp. 538. Price, $3.25. New York: Harper and Brothers, 1926.

This revision of the textbook which appeared first in 1921 gives every appearance of having been thoroughly and painstakingly done. Professor Hunter apparently is not a member of that rather large group whose concept of revision is the insertion of new dates in the proper places with, perhaps, an occasional change in statistics. In this case there has been not only an inclusion of the latest statistics in order to

bring the numerous tables up to date, and the recognition of legislative changes, but in addition, a sincere attempt has been made to note broader developments and changes in policy during the five-year period. An example of this occurs in the recognition of administrative reorganization of state government as a factor tending to secure more efficiency in expenditure.

Although the general viewpoint and method of approach remain practically unaltered, there has been considerable rearrangement in the order of treatment. At times this consists merely of changes of order within a particular chapter, with frequent transfers of complete topics from one chapter to another in order to secure a more logical and orderly treatment. In many cases, however, entire chapters have been transposed.

In addition, several new chapters have been added by expanding certain topics that formerly appeared as parts of rather bulky and incohesive chapters. For example, the discussion of public lands and public enterprises as a source of public revenue has been omitted from the chapter on the development of public revenue, and is now, with the addition of material on government ownership, elevated to the dignity of a separate chapter. A similar change has been made with respect to excises, capitation and business taxes, which were formerly treated together. The first two have been elevated to the rank of separate chapters, while the third is now one of a group of three chapters on "Taxes on Business," the other two being general corporation taxes, and taxes on special classes of corporations. New material appearing in this group has to do with the sales tax, taxes on motor transportation, automobile licenses, and the business license as used in southern states. Again, the treatment of public debts has been divided into two parts, entitled "general" and "administrative" considerations, with more emphasis on the purpose of borrowing, and new material on serial bonds, capital levy, and the settlement of the European debts. The income tax has also been divided into two parts, one on Federal, one on state systems, while the discussion of taxation now appears as two chapters—the nature of taxation, and justice in taxation. Although no separation of the chapter has been made, discussion of the single tax has been broadened to include taxes on mineral and forest lands, and the use of land taxes in foreign countries.

As contrasted with six chapters secured simply by separating and amplifying topics formerly treated elsewhere, only one completely new chapter appears, that being entitled "Characteristics of a Good Fiscal System." Much has been gained by separation, however, as it makes possible a more logical order of treatment, as evidenced by the grouping of the chapters on taxes on commodities, and it also tends to focus attention on subjects that were formerly apt to be ignored in the midst of other material.

As previously indicated, there has been little change in viewpoint either in general or on particular points. An exception occurs with respect to gift taxes. Formerly it was urged that gifts should be included in the category of inheritances for purposes of taxation, but in view of the administrative difficulties encountered by the Federal Government, this is now recognized as "extremely unsatisfactory." On the whole, however, the general approach remains unchanged. Those who formerly found the treatment unsatisfactory will doubtless find the new text equally so; those to whom it appealed will likely find the new edition much more teachable because of changes made.

CHARLES P. WHITE.

HANFORD, A. CHESTER: *Problems in Municipal Government*. Pp. 457. Chicago: A. W. Shaw Company, 1926.

"What is needed," declares Author Hanford, referring to the teaching of municipal government, "is a method of supplementing the lectures, text-books, and other readings which will assist the student in obtaining a more thorough mastery of the subject, develop his power of analysis, teach him how to apply his knowledge to actual problems, and help him to make the subject his own."

Recognizing the need, Professor Hanford has set out, laudably enough, to fill it. *Problems in Municipal Government* is his

contribution. "There have been gathered together in this volume almost one hundred problems, each of which covers an actual case which has recently arisen or is now pending in a particular American city," he explains.

The student is given the facts in each case, followed by a series of questions intended to stimulate thought. Under the heading "Organization of the Police Department," for example, the organization of Cincinnati's police department prior to the Upson upheaval is set forth in detail. Footnote references to standard secondary works are included, and with these as a background the student is supposed to answer intelligently, or at least enthusiastically, the following questions: "What features in the organization of the police department of Cincinnati do you consider worthy of praise? What defects do you find? What changes would you recommend?" Other topics are similarly treated.

The table of contents follows rather closely the classification of city activities used by Munro in his *Municipal Government and Administration*. A number of subjects are inadequately treated. Traffic regulation, one of the outstanding problems of every American city, is dismissed casually with two brief problems headed "Parking Regulations" and "Establishment of Traffic Court." City planning and public utility regulation are accorded but slightly better treatment.

The volume covers a wide field, however, and must of necessity be concise. It is an interesting experiment in the application of specific problems to the study of general phenomena. Whether it will help the average student to "make the subject his own" is an open question.

AUSTIN F. MACDONALD.

MACKAY, ROBERT A. *The Unreformed Senate of Canada*. Pp. xvi, 284. London: Oxford University Press, 1926.

We have in this monograph on the Senate of the Dominion of Canada a work of unusual merit. The subject is of perennial interest across the lines and ought to be of equal interest on this side, where many are asking if the states may not wisely follow the provinces in the abolition of their upper houses. It is unthinkable that the Federal Senate of the United States can or should be abolished, however great our impatience with it at times, for it is protected by a compact of the states in the Constitution. Our author asserts that Quebec sees in the Dominion Senate a potential guardian of provincial rights, that abolition is unthinkable to French Canadians, and that the Dominion, no less than the United States, is bound legally and morally by a compact.

He shows, furthermore, that the United Provinces of Upper and Lower Canada found an elected upper house incompatible with the efficient working of the parliamentary system. Therefore the Dominion fathers substituted an appointed Senate which they intended to be not only a second house but secondary, though to a degree independent. One of the leaders of the period of federation predicted, however, that the system would prove to be an alternation of deadlock with single-chamber control. The detailed accounts with illustrative tables marshalled by Mr. Mackay seem in spite of his intention to mark the acuteness of the prediction, for only when the Senate is controlled by the party in opposition to the government does it become active in the rejection of measures presented by the government. Previous studies in Canadian affairs had convinced the reviewer of the utter uselessness of the Dominion Senate, which arouses itself from peaceful slumber only when the people in a general election have voted a change of policy to pronounce its veto upon the consummation of that policy in law, and which later in the course of years relaxes its opposition as its composition changes, finally subsiding into peaceful acquiescence again. But Mr. Mackay carefully reviews the outstanding measures rejected by the Senate, and maintains that then, if only then, the upper house performs its proper function, and registers the true and permanent will of the people, as against active minorities which have imposed their views upon a spineless ministry. The defense of the Senate is strongly pressed, but my own attitude to social legislation, measures for the promotion of temperance and the pro-

tection of labor, is too pronounced to agree with the author. For instance, he pictures the gray-haired lawyers of the Senate, zealous for the tried principles of the common law, vetoing every one of a series of acts designed to raise the age of consent; my reading in Blackstone shows how inadequate the old law of England was and in Stephens how the English Parliament raised the age of consent in 1887 to a point these senatorial lawyers thought would be promotive of immorality in Canada. Mr. Mackay would prolong these occasional spasms of obstruction till the disease becomes endemic.

Another activity of the Senate, not so bitterly resented, is the amendment of measures coming up from the House of Commons. This as proved by the detailed statements and illustrative tables is not intermittent but constant, rising no higher when the two houses are in opposition to each other than when they are in political accord. The leisurely body of experienced legislators here performs a function of real value, especially in the protection of property, the symmetrical development of the law and careful drafting.

This monograph has several valuable suggestions upon the functions which may well be conceded to the Senate. Just as now all divorce bills are first introduced in the Senate and the procedure is essentially judicial, so all private bills might be assigned to the Senate. Now the Senate, like the House of Lords, gives admirable service in the consideration of such bills. Members of the lower house no doubt desire to introduce private bills and further their passage, but the procedure ought to be impersonal and judicial. At the present time the number of such bills introduced in the Senate tends to increase, yet the great majority are introduced in the lower house.

Non-contentious government bills almost always make their first appearance in the lower house, introduced by heads of departments, for seldom is there more than a single department head in the Senate, and sometimes none at all. If every minister had the privilege of the floor in both houses it might often be convenient for ministers to introduce these non-partisan bills in the Senate. Partisan bills occupy much attention of the members of the House of Commons and non-partisan bills do not have the prompt and adequate attention they would receive in the Senate if introduced there early in the session.

Mr. Mackay proposes changes in the composition of the Senate, which, judging from somewhat similar provisions in other national upper houses, would greatly enhance the utility and dignity of the Senate, without unduly increasing its independence. He proposes a Senate that shall not only represent the four sections of the country, but the various shades of political opinion. One-half of the Senators would be elected by the members of the House of Commons, one-third renewed at the beginning of each newly elected Parliament. The members from a section would elect their Senators by proportional representation from candidates with the qualification of previous election to the Senate, House of Commons, or provincial legislature. The remaining half of the Senate would be appointed by the government, renewed as in the case of elected members, part from tried administrators from the several sections, and part nominated by various national associations. Thus functional representation and the valuable co-operation of trained administrators would find recognition in the composition of the Senate.

Altogether the book is sane, well-documented, and informing.

CHARLES H. MAXSON.

ROGERS, LINDSAY. *The American Senate*. Pp. xii. 285. New York: Alfred A. Knopf. 1926.

The author does not attempt in this brief volume on the Senate of the United States to write either a comprehensive history or a dispassionate analysis of the functioning of that venerable institution. He states in his preface that he expects to argue a point of view. His view is this: "The undemocratic, usurping Senate is the indispensable check and balance in the American system, and only complete freedom of debate permits it to play this rôle." The author feels very strongly that it would be clearly inadvisable to change the present rule of freedom of debate in the Senate, since, in

his opinion, senatorial investigations of the executive would become less numerous and less effective, if a Senate majority could act whenever it cared to act.

The author devotes a comparatively small portion of his volume to the Senate as a legislative chamber. "Closure," "Congressional Investigations," "Presidential Propaganda and the Senate," "Forum of the Nation and Critic of the Executive" are the subjects which chiefly engage the attention of the author. It is in the chapters dealing with these subjects that the author is at his best. In emphasizing the importance of preserving inviolate the informing function of Congress, he brings forward an aspect of the closure controversy too long neglected and too frequently unnoticed. Herein lies the chief merit of the volume.

M. L. FAUST.

JENNINGS, W. W. *History of Economic Progress in the United States.* Pp. xvi, 822. Price, $5.00. New York: Thomas Crowell & Company.

From time to time for almost a generation we have been favored with various American economic histories. They have increased considerably in size, but their general outline has remained strikingly similar. Chapters are devoted to agriculture, manufacturing, commerce and finance in the Colonial, early national, ante-bellum, post-bellum, and 20th century periods. This has given an unreality and statistical quality to our economic story, which does its best to destroy the interest of students. There are few portions of history more striking or more significant than the progress of our economic development, but to date no one seems to have grasped its potentialities as a vital possibility. Mr. Jennings' book is the latest in the line. It is a monument of patience and research, its scope is really tremendous. Its 748 pages of text, its statistical appendices and its bibliographies contain an arsenal of facts and figures which is staggering; not a word is wasted in attempting embellishment, the facts are there and nothing but the facts. But of the significance and interpretation of these facts all that is attempted is a strain of evangelism which finally bursts forth as the writer views the 20th century and sees what he thinks is needed to save America. This volume will be an invaluable reference book and an indispensable aid to any one studying our economic history; for producing this the author cannot be praised too highly, but the vital synthesized coherent story of one of the greatest episodes of economic history has yet to be written.

ROY F. NICHOLS.

ISE, JOHN. *The United States Oil Policy.* Pp. x, 547. Price, $7.50. New Haven: Yale University Press, 1926.

The theme of this volume is conservation of petroleum. Professor Ise's approach to the problem is an historical and research rather than a philosophical one. This is, of course, proper, but it leads him into difficulties that make the book unreadable. Mingled with the text on every page are dozens of statistical items that soon pall and lose their significance. It was the author's duty to collate and interpret these.

An historical analysis of each of the major fields occupies one-third of the book and is well done, as is also the discussion of the public oil land problem. Chapters on the questions of substitutes and foreign supplies and on conclusions conclude the treatment. Copious references increase the value of the work. A. H. WILLIAMS.

REED, HAROLD L. *Principles of Corporation Finance.* Pp. 412. Boston: Houghton Mifflin Company, 1926.

In this work the author has organized the materials of corporation finance in such a way that the student may "readily comprehend the relationship of the different aspects of the subject." His avowed plan is to follow through the life of the business corporation from its inception to its dissolution. The work is divided into five parts, the first dealing with the financial problems of a new corporate enterprise, the second with current operations, the third with earnings, the fourth with corporate expansions and the fifth with failures and reorganizations.

It is difficult to understand why the author begins his treatise with an extended discussion of no par value stock, overcapitalization, bonus shares, assessible stock and other features of different classes of

stock before analyzing the rôle played by the promoter and the steps necessary in forming a new business enterprise. Again, the logic of discussing the justification of the work of the promoter before describing the functions which he performs may also be questioned. To enumerate the results of reorganization before giving a description of methods of reorganization likewise appears to be putting the cart before the horse.

The lack of concrete illustrative materials and of substantiating evidence to support the many general observations seems to the reviewer to be an outstanding weakness of the treatise. It is doubtful whether such generalizations as the following could be corroborated by available data: "Those who assume the risk of shareholders will demand, as compensation, a share in control" (p. 310). "Ordinarily the new issue will be for as many shares as are already outstanding" (p. 316). "At any rate, available evidence seems to indicate that monopoly powers possess far greater opportunities in the case of investment than in the case of commercial banking" (p. 338). Many such sweeping statements as these, unsupported by any corroborating evidence, might be cited.

In an advanced treatise, such as this work purports to be, a more detailed analysis of many phases of corporate financing would also be desirable. Maintenance, betterments, depreciation financing, underwriting syndicates, corporate leases, equipment trust certificates, reorganization of capital account, reorganization by court order and similar topics are either omitted from the discussion entirely or receive only very inadequate treatment.

In spite of these and similar weaknesses, however, the book may be profitably read by the student of corporation finance, because of the many stimulating suggestions which it contains. KARL SCHOLZ.

REED, THOMAS H. Professor of Municipal Government in the University of Michigan. *Municipal Government in the United States.* Pp. 368. New York: The Century Company, 1926.

Professor Reed's book constitutes a valuable and useful addition to the Century Political Science Series. The chapters dealing with the historical development of municipal institutions in the United States are so admirably conceived and executed that one cannot fail to hope that Professor Reed will not abandon his early enthusiasm for the writing of a history of municipal government that will be, to use his own phrase, "comprehensive and definitive." Equally commendable are the simplicity, precision and clarity of the chapters describing the legal position of the city in the United States.

Unfortunately one cannot manifest a similar degree of enthusiasm for some of the later chapters of the book. Chapter XVII, entitled "The Perfection of Administration," may be mentioned in particular. By comparison with other portions of the book this chapter is so superficial and fragmentary as to impress one as being scarcely more than an afterthought.

One who writes in the field of municipal government must deal with a larger and more varied mass of minute fact material than is to be encountered in any other division of political science, and hence finds it extremely difficult to escape the charge of inaccuracy. It is therefore very greatly to Professor Reed's credit that the inaccuracies which appear in his book are so few and of such slight importance.

As to the suitability of this book for use as an undergraduate text-book opinions are bound to differ. From the standpoint of the reviewer it would serve this purpose better if it dealt more with the functional and operative side of city government than with the historical and legal aspects.

CHESTER H. MAXEY.

COLLINS, CHARLES W. *The Branch Bank Question.* Pp. xi, 182. Price, $1.75. New York: The Macmillan Company, 1926.

Mr. Collins has presented, in this well-written book, a carefully worked out history of the branch banking controversy in America, especially in its political and legislative aspects. The story has been brought down to December, 1925, since which time little of significance has happened to the question, so that the account is still fairly up-to-date.

The facts are, briefly, that twenty-eight states do not allow any form of branch

banking, while twenty states permit branch banking, in some cases city-wide and in others state-wide, to state chartered banks. In the branch banking states national banks are being subjected to a competition which is proving too strong for many of them. To their aid have come several rulings of the Comptroller of the Currency permitting national banks in certain cities to open branch "offices" in the same city in which the bank is located. This informal arrangement does not seem to meet the situation entirely, especially in states like California which permit state-wide branch banking to state banks. Accordingly the McFadden Bill, giving limited branch banking powers to national banks in states in which state banks have such powers and curtailing to some extent Federal Reserve membership to state banks practising extensive branch banking, has been battling its way in the past two Congresses. The bill seems to have a decisive majority in favor of its main features, but encounters serious disagreement over details, especially whether or not the Federal Reserve System is to be open in the future to banks operating state-wide branches.

While the author discusses ably the legal and political turns, one misses a thoroughgoing analysis of the economic issues—involved issues—which will ultimately decide the legal and political outcome. We look in vain for a discussion of branch banking's advantages and disadvantages to borrowers and depositors, the advisibility of having the community's banking resources controlled by absentees, the effect of branch banking on interest rates, and the tendency toward the parallel development of large-scale industry and finance.

The work is, however, as far as it goes, a valuable treatise and forms a welcome addition to the literature of banking.

ALBERT S. KEISTER.

FOERSTER, ROBERT F., and DIETEL, ELSIE H. *Employee Stock Ownership in the United States.* Pp. viii, 174. Price, $1.50. Pub. by the *Industrial Relations Section*, Princeton University, 1926.

This treatise is an inquiry into the nature of upward of three hundred employee stock ownership plans, as well as a discussion of the general questions raised by the provisions of these various plans. The authors make no attempt to evaluate the relative merits of the plans studied, nor do they set forth what may be termed a model employee stock ownership plan. In their opinion the time is not yet ripe for a "succient statement of the principles to be observed in constructing such a plan." The appendix contains a summary of the provisions of the plans examined, together with the dates of their inauguration, and wherever possible, the extent to which employees have accepted the offers to participate in stock ownership.

The treatise, in general, appears to lack that scientific precision of phraseology which one should like to find in an objective, factual analysis of materials. Expressions such as "sometimes," "in many instances," "usually," "generally," "in a few instances," and the like convey no precise idea of the relative importance of the specific provisions discussed. Attention might also be called to the error in the use of the expression "treasury shares" on page 71. The authors make the statement "Whether treasury shares are sold or shares previously outstanding and bought by the company in the open market, no direct profit accrues to the company from their sale." The inference here is that treasury shares consist of authorized but unissued shares, which have not been outstanding previously. This is contrary to the accepted usage of the expression "treasury shares."

These minor adverse criticisms, however, can scarcely detract from the merits of an otherwise valuable and timely presentation of a subject which appears to be attracting ever wider attention among financiers and industrial managers.

KARL SCHOLZ.

HERROLD, LLOYD D. *Advertising Copy—Principles and Practice.* Pp. xiv, 525. Price, $6.00. Chicago and New York: A. W. Shaw Company.

In this book Professor Herrold treats one of the technical phases of advertising in a new way. He develops the idea that copy should be considered not as an independent and unrelated unit but as an integral part of a complete advertising campaign. We are, therefore, shown the necessity for

complete analysis and thorough unification of the elements of copy with the sales function and its relation to the finished campaign.

The text is concerned with writing copy for particular media. In this respect a method is used which involves an analysis of the medium, the type of copy to be used and the reasons for that use. This is a new procedure and differentiates the book from others in the immediate field. The psychological aspects as set forth in the chapter concerning the appeals to be selected for a campaign is descriptive rather than creative in its approach.

There are many illustrations and much specific data with which the theorist may work. This is particularly valuable for the teachers who have deplored the scarcity of factual campaign material. On the other hand those in the practical field see comments upon their own handiwork from the point of view of the analyst. The chapter upon "The Analysis Preceding the Writing of Copy" can be used by all those interested in research method, for it effectively outlines the actual procedure employed by research departments in advertising agencies before the copy is prepared.

Although copy was effectively treated in Professor Herrold's former book, a distinct contribution has been made in this volume by reason of its completeness.

J. RUSSELL DOUBMAN.

REED, RUTH. *Negro Illegitimacy in New York City.* Pp. 134. Price, $2.25. New York: Columbia University Press, 1926.

The appearance of this brochure (No. 277 of the Studies in History, Economics and Public Law edited by the Faculty of Political Science of Columbia University) upon a controversial phase of the Negro question will be greatly valued by those interested in a scientific study of this problem.

With but five hundred cases—the sum total available—Miss Reed has made a thorough scholarly and sympathetic study of this unconventional condition among Negro women of New York. She has given us "an analysis of the chief facts in the personal and environmental history of a group of unmarried Negro mothers who have at one time or another during the past five years come to the attention of the social agencies of New York City." It is a stark piece of work well done. There is an excellent table of contents, a complete bibliography, tables intelligible to the layman, a brief history of society and the unmarried mother in general and of the Negro unmarried mother in particular.

The student of social problems or of history should welcome as invaluable data Miss Reed's compact study. It is a crowded volume and shows a few effects of its abbreviation, but it is remarkable for its judicial treatment of an opinionated subject. Columbia University Press has indeed with this volume added to its collection admirable data for future studies for comparison. Miss Reed points out, however, that there exists no such data or material for other groups in this country.

SADIE MOSSELL ALEXANDER.

WEBER, GUSTAVUS A. *The Hydrographic Office—Its History, Activities and Organizations.* No. 42. Pp. xii, 112. Price, $1.00. United States Service Monographs. Institute for Government Research. Baltimore, Md.: The Johns Hopkins Press.

SMITH, DARRELL HEVENOR. *The Bureau of Naturalization, Its History, Activities and Organization.* No. 43. Pp. xii, 106. Price, $1.00.

TOBEY, JAMES A. *The National Government and Public Health.* Pp. xviii, 423. Price, $3.00.

HUNT, ELIZABETH PINNEY. *Arthur Young, on Industry and Economics.* Pp. 183. Bryn Mawr, Pa., 1926.

FISHER, LILLIAN ESTELLE. *Viceregal Administration in the Spanish American Colonies.* Pp. x, 397. Berkeley, California: University of California Press, 1926.

Where to Turn. Pp. 44, Price, 25 cents. Philadelphia: Public Charities Association, Publication No. 1, 1926.

The first distribution of an attractive handbook, entitled *Where to Turn* is just being made by the Welfare Information Bureau of the Public Charities Association of Pennsylvania. The pamphlet briefly describes the various types of welfare activities and gives a concise directory of national, state and local social service agencies.

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SOCIAL AND ECONOMIC CONSEQUENCES OF BUYING ON THE INSTALMENT PLAN

BY

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SIMON N. PATTEN FELLOW
Appointed by the American Academy

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SOCIAL AND ECONOMIC CONSEQUENCES OF BUYING ON THE INSTALMENT PLAN

FOREWORD

INSTALMENT buying has recently had a phenomenal growth. Its growth has been such that that form of buying has become a really new economic institution. It is, therefore, particularly pertinent that the Academy should have a special study made of this subject at just this time.

Dr. W. C. Plummer of the University of Pennsylvania was chosen to make this study and also to be the first of the Simon N. Patten Fellows named by the Board of Trustees of the Academy. Dr. Plummer's research work is characterized by thoroughness and he is equipped with a well-trained mind for frontier work. It is just this quality of frontier work that would be most gratifying to the late Professor Patten, one of the founders of the Academy, in whose honor this fellowship was created.

This monograph is sent out in the hope that it may prove useful in fact and in reasoning to those who are wrestling with the economic and social consequences of instalment buying, a problem of great importance now and destined no doubt to be of special significance in the days of crisis and the days of prosperity always ahead.

CLYDE L. KING,
Editor.

ACKNOWLEDGMENTS

THE author wishes to acknowledge his indebtedness to the American Academy of Political and Social Science which has made this study possible. He is also greatly indebted to Dr. Clyde L. King, Dr. Ernest Minor Patterson, Dr. Harry T. Collings, Dr. Raymond T. Bye, Dr. S. Howard Patterson, Mr. Charles P. White, and Mrs. Florence B. Plummer for assistance, some of whom have read portions of the manuscript and have given the benefit of their criticisms on it; others have called the writer's attention to material appearing in the numerous current publications, a great deal of which would otherwise have escaped his notice.

WILBUR C. PLUMMER.

December 10, 1926.

Social and Economic Consequences of Buying on the Instalment Plan

I. THE ORIGIN, GROWTH AND PRESENT EXTENT OF BUYING ON THE INSTALMENT PLAN

What Is Meant by Buying on the Instalment Plan?—An instalment sale or purchase is one in which the price of the goods is to be paid in fixed portions at stated intervals. Aside from a cash or down payment, which is usually made at the time of sale, the transaction is simply a credit or deferred payment transaction in contrast to a cash payment and does not differ in its nature from any other credit transaction. As stated above, instalment credit provides for the payment of the debt in regular and fixed instalments, and in this respect, it is a sort of funded debt in contrast to a demand obligation, which is payable at the request of the creditor or to the old-fashioned book credit or charge account or open account, which was payable in whole or in parts at the convenience of the debtor. It also stands in contrast to the kind of debt which runs for a stated period and which is to be paid in a lump sum at the end of the period.

In buying on the instalment plan, the goods are delivered to the buyer, but the title to them generally remains in the seller and does not pass to the buyer until all the instalments are paid. In some cases, however, the title passes immediately to the buyer, and he gives a mortgage on the goods as security for the balance due. Default in payment in almost all cases gives the seller the right to the possession of the goods; it also quite frequently forfeits all previously paid instalments. It is difficult to generalize on the legal aspects of instalment selling, as there is a complex body of statutes governing this form of sale in each of the forty-eight states. However, efforts are being made with some success to secure the enactment of uniform laws governing conditional sales in the various states. A Federal law is impossible without constitutional amendment, and in its absence uniformity is almost impossible.

Origin of the Practice.—Instalment buying is an old practice. Writers on the subject have cited numerous instances from history to show how old the practice really is. It is said that Crassus, the contemporary of Julius Caesar, made a large part of his enormous fortune by building houses outside the walls of Rome and selling them on the instalment plan. A recent writer mentions an instalment transaction, similar to those of the present time, which took place a century ago. The Countess of Blessington at one time found herself in the disconcerting circumstance of greatly desiring a suite of furniture which she was unable to purchase because she lacked the necessary funds. Her desire for this suite of furniture was too great, however, to be thwarted by insufficient funds, and so she contrived a plan of partial payments and persuaded the cabinet-maker to accept, in lieu of cash, a down-deposit representing a fraction of the cash price, a lien on the furniture, and a promise of further payments to be made at regular intervals until her debt should be entirely liquidated. The practice of the present time, in principle, is not greatly different from what it is said to have been in this particular case of one hundred years ago.

An idea as to the length of time

selling on the instalment plan has been practiced in this country, as well as the character of the goods thus sold, may be gained from the fact that building and loan associations, which provide for the buying of houses on this plan, have been in existence for more than seventy-five years. The Singer Sewing Machine Company has been doing a very profitable business in this manner for more than fifty years. There are also numerous piano and other musical instrument houses that have been selling this way for the same length of time. McCormick reapers and binders have been sold in this manner almost from the beginning of their use. Equipment purchases of railroads have been made on the partial payment plan for many years. The *Encyclopaedia Britannica* has been sold on instalments for many years. In 1898, this company launched a campaign in England which was remarkably successful for selling the work for one guinea cash and thirteen monthy payments of one guinea each.

Growth and Present Extent.—Even though instalment selling, similar to that which exists at the present time, has been a common practice for the past fifty years, there had been comparatively little growth of the system until recent years. Within the last decade, however, instalment selling has undergone an enormous expansion in both volume of sales and number of industries affected. About 1915, instalment selling was introduced into the automobile business, where it experienced a somewhat gradual growth for several years, and then, after 1920, it suddenly expanded, reaching great volumes within a few years' time. In the industrial depression of the latter part of 1920 and the year 1921, the system spread to other lines of business and grew rapidly to the large proportions of the present time.

Exclusive of houses, life insurance, and stocks and bonds, all of which are sold on instalments on an extensive scale, it is estimated that approximately six billion dollars' worth of goods are now sold at retail annually on the instalment plan.[1] The total annual retail sales of all commodities are estimated at approximately forty billion dollars. Thus, fifteen per cent of all goods bought at retail are purchased on the instalment plan.

It is estimated that the amount of the instalment debt outstanding *at a given time* is $2,750,000,000. This is a more significant figure than the six billion dollars which is the total of the instalment sales over a period of one year's time. When considered as an absolute quantity, the instalment debt outstanding at a given time is a large amount, but when considered in relation to the total outstanding debt of the community, that is, the total amounts owing from all individuals or groups of the community to all other individuals or groups of the community, it is very small. The total amount of credit of all kinds, including instalment credit, outstanding at a given time in this country, not counting funds borrowed for the purpose of re-loaning, is very greatly in excess of $120,000,000,000 or $130,000,000,000.[2]

Automobiles, standing far above all the other commodities in importance, account for approximately $1,500,000,000, that is over half of the instalment debt outstanding at a given

[1] No one knows what the total annual instalment sales are. This is a figure commonly used and accepted as an approximation by bankers, economists and others. It is the estimate of the National Association of Credit Men and also of Mr. Milan V. Ayres who conducted an investigation into instalment buying for the Economic Policy Commission of the American Bankers' Association.

[2] *See* page 43 of this study.

time.[3] Seventy-five per cent of all automobiles, considered with respect to value, are sold on these terms. Household furniture is the second commodity in importance, accounting for approximately nineteen per cent of the total instalment debt, according to the estimate of Mr. Milan V. Ayres who made an investigation for the American Bankers' Association. Eighty-five or ninety per cent of all furniture is bought on instalments.[4] The prevalence of the instalment plan of selling furniture is shown by the fact that out of five hundred and fifty-six retailers responding to a questionnaire sent out by the Federal Trade Commission regarding the point, only thirteen reported that they regularly sell furniture strictly for cash.[5] It is estimated that eighty per cent of all phonographs are sold on instalments, seventy-five per cent of washing machines, sixty-five per cent of vacuum cleaners, twenty-five per cent of all jewelry,[6] and the greater part of all pianos, sewing machines, radios and electric refrigerators. About $140,000,000 worth of clothing is sold annually on deferred payments,[7] but since the term of payments for this commodity is comparatively short, the amount of credit outstanding at one time is only about $40,000,000, which is but one and four-tenths per cent of the total instalment debt.

Total Volume of Instalment Sales.—Whether instalment selling is increasing or not at the present time is a debated question. It is the contention of some people that the rapid expansion came in the years 1920–23, and since that time there has been very little growth. They say that public attention has just become focused on the subject, thus giving the impression that there is a tremendous increase taking place at the present time, when such is not the case.

The results of an investigation by the Economic Policy Commission of the American Bankers' Association, which have not been made public, although parts of it have appeared in print in a number of places, say that the instalment debt at the end of 1925 was seven per cent greater than at the end of 1923. Mr. Milan V. Ayres, who conducted this investigation and who has continued his study of the subject, states that the instalment debt at the present time is only eight per cent greater than at the end of 1923.

We are fortunate in having some careful figures in regard to the recent growth of instalment selling which tend to the conclusion that the system is still expanding in volume. These statistics, while accurate, are very limited in scope. The Federal Reserve Bank of Boston has collected information on instalment selling in the department stores of Boston, and the Federal Reserve Bank of Philadelphia on the sales of automobiles in the Philadelphia Reserve District. We have gathered some information on the subject from other sources and it also indicates that instalment selling is still on the increase.

The material of the Federal Reserve Bank of Boston refers to instalment

[3] This figure is probably not far from being exactly correct, as there is a great deal of very definite information available concerning the total production and sales of automobiles. This is the estimate of Mr. C. C. Hanch, General Manager of the National Association of Finance Companies, and is supported by the estimates of others.

[4] Report of the Farmers' Loan and Trust Company of New York.

[5] Report of the Federal Trade Commission on House Furnishings Industries, January 17, 1923, Vol. I, p. 12.

[6] Estimates on phonographs, washing machines, vacuum cleaners and jewelry by the Farmers' Loan and Trust Company of New York.

[7] Estimate on clothing by Ayres, M. V., *The Christian Science Monitor*, November 17, 1926.

accounts, not sales, but as the collections have been maintained at a satisfactory rate, that is, collections have increased as rapidly as the volume of accounts, these statistics reflect the growth of instalment business. The tables below show instalment accounts outstanding at the close of each month of 1925 compared with the same month in 1924, also the amounts outstanding at the close of each month of 1926 up to and including May, as compared with the same month in 1925. It will be noticed that during 1925 instalment accounts at the close of each month were from twenty to one hundred and ten per cent greater than the total outstanding at the end of the corresponding month of the previous year, and that the accounts at the close of the months of 1926 were from seventy-four and eight-tenths to one hundred and thirty-four per cent greater than the total volume outstanding at the end of the corresponding months of 1925. The amount of regular charge accounts in 1925 outstanding on corresponding dates, we are informed, showed little variation from those of 1924. The same is true of 1926 as compared with 1925.[8]

Bearing in mind what was said about the satisfactory collection of the accounts, it is evident that there was a tremendous increase in the instalment business of the Boston department stores in 1925 over that of 1924, and that this business continued to increase

INSTALMENT ACCOUNTS OUTSTANDING AT END OF MONTH IN BOSTON DEPARTMENT STORES, 1925, COMPARED WITH 1924[9]

Month	Per Cent Change 1925 Compared with 1924	Month	Per Cent Change 1925 Compared with 1924
January	+29	July	+43
February	+20	August	+52
March	+21	September	+84
April	+23	October	+82
May	+31	November	+110
June	+42	December	+88

DEFERRED ACCOUNTS AND REGULAR ACCOUNTS OUTSTANDING AT END OF THE MONTH IN BOSTON DEPARTMENT STORES, 1926 COMPARED WITH 1925

Month	Instalment Accounts—Per Cent Change 1926 Compared with 1925	Regular Accounts—Per Cent Change 1926 Compared with 1925
January	+134	+8
February	+109.2	+4.5
March	+104.3	+3.0
April	+ 97	−1.0
May	+ 74.8	+2.5

[8] Correspondence, Warren, R. A., Manager Industrial Statistics Division, Federal Reserve Bank of Boston, June 16, 1926.

[9] For all months except December, data taken from chart in the *Monthly Review of the Federal Reserve Bank of Boston*, January 1, 1926; for December, Correspondence, Federal Reserve Bank of Boston.

at a rapid rate in the first five months of 1926.

We have information in regard to one of the large department stores of New York City which also points to the conclusion that the total volume of instalment sales is increasing. Sales of this particular organization in 1926 show an increase of twenty-eight and twenty-three hundredths per cent over those of a corresponding period for 1925.

The statistics which we have in regard to the instalment sales of automobiles also tend to show that the total volume of instalment sales is increasing. The Federal Reserve Bank of Philadelphia has been receiving reports from fifteen distributors of automobiles in the Philadelphia Reserve District, and the compilations of these reports, which have been published in *The Business Review* for August, September and October, 1926, indicate that retail instalment sales, considered with respect to *number* of cars, in May, June, July and August, 1926, were 8.9 per cent, 19.3 per cent, .9 per cent and 45.8 per cent greater than those of corresponding months of 1925. Considered with respect to *value* of cars sold on the instalment plan, the per cent change in May, June, July and August, 1926, from the corresponding months of 1925 were respectively +8.6, +33.3, −1.0, and +16.4.

The great increase in the production and sale on instalments of mechanical refrigerators and radio sets of the past year or two and which continue at the present time also point to the conclusion that the total volume of instalment sales is increasing. The production and instalment sales of mechanical refrigerators are said to have increased four hundred per cent in the past two years and the prospects are that the output and volume of instalment sales will be still further increased during the coming year. By far the larger part of all mechanical refrigerators are being sold on instalments. It is estimated that the total volume of instalment sales of radios has increased two hundred per cent in the past two years.

As we stated above, whether instalment selling is increasing or not at the present time is a debated question. The facts necessary for a proper determination of the question are not available, but all the information that we have been able to gather on the subject points to the conclusion that the total volume of instalment sales is still on the increase.

Instalment Selling in Foreign Countries.[10]—In England instalment buying is known as "hire-purchase," and has been in use for many years in various branches of the furniture trade. At the present time, a large business on the hire-purchase plan is done in Great Britain in the sale of machinery, agricultural implements, automobiles, furniture and musical instruments. It is reported that sixty per cent of the automobiles are sold by this method of payment.[11] In regard to pianos, the practice is so common as to have become a "custom" in the eyes of the law. The same custom is recognized by British law in regard to barges, gas and steam engines, printing machinery, railway cars, and sewing machines. Eighty per cent of pianos, seventy per cent of sewing machines and fifty per cent of all furniture are sold on the part payment basis.[12]

[10] The material on this subject is derived largely from the following publications of the Bureau of Foreign and Domestic Commerce, Department of Commerce, on Instalment Sales in Foreign Law, published October and November, 1925: I, British Empire and Latin America; II, Continental Europe, North Africa and Asia.

[11] Chisholm, C., *The Manchester Guardian Commercial*, September 16, 1926.

[12] *Ibid.*

French law recognizes a form of conditional sale in which the title passes to the buyer on payment of the last instalment. Such a sale is known as a *vente à tempérament*. Automobiles, house-furnishings, musical instruments, typewriters, sewing machines, and real estate are some of the principal classes of goods sold in this manner.

In Germany sales on the instalment plan under which title to the property remains vested with the vendor are customary, and are becoming increasingly popular. During the inflation period, however, it was very rare. At that time sales were necessarily made for cash in view of the quick depreciation of the currency.

Automobile financing companies report that eighty-three per cent of the automobiles in Canada have been purchased on the part payment plan. This is a higher per cent than in the United States. It has been estimated that fifty per cent of the sales of machinery, agricultural implements, furniture, and musical instruments in Canada are on the instalment plan.

The same selling methods employed in the United States are used extensively in Brazil and Chile, the practice being traceable to the growth of the practice in the United States. The articles mentioned as being sold in these countries are automobiles, machinery, agricultural implements and musical instruments. Instalment selling is being extended in Brazil and the same is the case in Peru, although the growth is being retarded in the latter country, chiefly due to the lack of specific guaranty of the rights of the seller under Peruvian law.

Articles of furniture, houses and lots are sometimes sold on instalments in Japan. In that country, automobiles are used mostly by people of means and are sold for cash payment. The representative of the Bureau of Foreign and Domestic Commerce, who collected information on instalment selling in Japan, thought that the instalment selling of automobiles, especially those of low cost, would stimulate the use of them by the people at large.

The generalization which one can make in regard to instalment selling in foreign countries is that the practice is quite common in many countries, particularly those mentioned above. But the practice does not seem to extend to clothing and jewelry as in this country. Furthermore, some of the articles most commonly bought on these terms in the United States, such as electric washers, vacuum cleaners and electric refrigerators, are not mentioned at all in the reports from those countries. This may be because electricity has not been put within reach of the the masses of the people in those countries. Automobiles, the particular commodity which is causing so much concern in our country, are sold extensively on these terms in many countries, particularly Canada and England. Instalment selling is *increasing* in many countries, but apparently it is not growing so rapidly as to cause an alarming condition as is thought by some people to be the case in the United States.

II. THE CAUSES OF THE GROWTH OF INSTALMENT BUYING

Unused Productive Capacity.—In considering the fact that instalment selling, in very much the same form as it exists at the present time, had been a common practice in this country for fifty years before the recent extension of it, and that there had been comparatively little expansion in the

system in all these years, one naturally asks: "What are the forces which so suddenly have brought about the expansion of this form of selling to such amazing proportions within such a short period of time?"

It is generally agreed that the beginnings of the recent expansion are to be found in the automobile business. In the beginning of the industry, manufacturers sold all cars at wholesale strictly for cash [13] and opposed the retailer selling cars on any other terms than cash.[14] In time, however, through a desire to increase sales and reduce the unit costs of production, plants were expanded and the manufacturers changed their attitude in regard to the retailer granting credit to the consumer.[15] The easy terms to the consumer which were finally granted increased the amount bought, and as the automobile business has hitherto been subject to the law of increasing returns, the unit costs were decreased, thus under competitive conditions lowering the price to the consumer. The lowered price increased still further the amount demanded, and brought about a still further expansion of plant and equipment. The automobile industry is said to be overexpanded at the present time. Mr. C. E. Gambill, President of the National Automobile Dealers' Association, is authority for the statement that automobile manufacturing plants have been built up to a capacity of around 6,000,000 units a year, and that even with the unprecedented business of 1925, this means that actual production was only about seventy per cent of capacity.[16] As a result of this unused capacity, manufacturers are under great inducement to depart from what has come to be known as standard terms of automobile financing[17] in order to secure increased sales, and thus distribute the overhead expense over a still larger number of units.

A cause for the great growth of instalment selling since 1920, is to be found in the excess productive capacity existing in many other lines of business during the depression of the latter part of 1920 and the year 1921. In the years just prior to 1920, plant and equipment had been expanded in the hope of great profits which were possible in the period of rapidly rising prices, and then, when the depression came, some of these industries, burdened with overhead costs, profited by the experience of the automobile industry, and resorted to easy terms to the consumer as a means of increasing sales. The automobile business itself profited by its earlier experience and developed the instalment system to a degree that made its former efforts in this respect seem insignificant in comparison.

Competition Between the Same Kinds of Goods.—Competition between those selling the same kinds of goods is a causal factor in the growth of the system. Under a régime of competitive business whatever is generally advantageous becomes a necessity for all competitors. If partial payment selling in a certain line of business stimulates sales and is successful otherwise, the individual who refuses to use this device suffers. He will not gain new business that he might have by offering easier terms and he may lose some of his present customers who are attracted to his com-

[13] Correspondence, Maddock, E. S., New Amsterdam Credit Corporation, August 2, 1926.

[14] Hanch, C. C., General Manager, National Association of Finance Companies.

[15] Boeckel, R., *Instalment Buying in the United States*, p. 12.

[16] Gambill, C. E., Address delivered at the annual convention of the National Association of Finance Companies, Chicago, Illinois, November 16, 1925.

[17] One-third of purchase price cash and the balance in twelve equal monthly payments on new cars, and forty per cent down with twelve equal monthly payments on used cars.

petitor by the partial payments. The competition extends further than the mere granting of credit; it includes the offering of easier credit conditions in smaller down payments and a longer time in which to pay the balance. The tendency in some instances to depart from the standard conservative terms mentioned above may also be attributed to competition among retailers engaged in the same kind of business, among manufacturers producing the same commodity, and among finance companies and among banks for business in lending funds to finance instalment sales.

Competition Between Different Kinds of Goods.—Another kind of competition, perhaps not so evident as the one just mentioned, but a real one nevertheless, is the competition between different kinds of goods. It is believed generally that if people had to pay in a lump sum for radios, automobiles, mechanical refrigerators, etc., that there would be fewer bought. Consequently this purchasing power which is now spent for radios, automobiles, mechanical refrigerators, etc., if it were not saved, would be diverted to the purchase and consumption of something else, if there were no deferred payment terms. If the individual pledges his future income for automobiles, pianos, and vacuum cleaners, he will buy less clothes and food or other things than he would otherwise, unless he is able to increase his income by working harder under the stimulus of instalment debts. *This latter condition is possible, and if it is happening, one of the important economic and social effects of instalment buying is the increasing of production and the raising of the individual's standard of life.* In the opinion of many people there is occurring a diversion of purchasing power such as has been mentioned here. This opinion is indicated by such comments as the following: "For a long time I have felt that the buying of automobiles on the instalment plan in such volume was one of the outstanding reasons for slow business in many industries." [18]

The following statements contain the same idea: "In order to possess nonessentials, many families are cutting down on essentials, setting a less nourishing table, buying fewer shoes and skimping on living quarters." [19] "It is bad for a single industry like the automobile to make such deep inroads upon current earnings of individuals that the clothing, provision and construction industries might be starved." [20]

Advertising and High Pressure Salesmanship.—Modern methods of advertising and high pressure salesmanship are without doubt partly responsible for the extension of instalment selling among the poorer classes. The following statement, by one whose knowledge of the incomes, expenditures, and needs of the poorer classes is such as to make his words carry weight, is worth repeating in connection with his point, although it was not made in connection with instalment selling: "Did you ever think of the strain to which people with small incomes are subjected by our continual pursuit of them to spend their money? Every newspaper, every magazine, every street, every railroad track, every street car, every country road is lined with advertisements carrying suggestions intended to be subtle, though often they are blatant, to buy, buy, buy. Every human impulse, good and bad, is played upon.

[18] Johnson, J., Chairman of the Board of Directors of the International Shoe Company, *see* Report of the Farmers' Loan and Trust Company of New York on "Instalment Buying."

[19] Hill, C. J., Babson Institute, Wellesley Hills, Massachusetts, in *The New York Times*, February 13, 1926, p. 8.

[20] Tregoe, J. H., Executive Manager of the National Association of Credit Men.

Not only do we advertise publicly, but we send letters and agents to the homes to try to extract from any and every one what money he has. In every way we set about deliberately to make a person feel that life will be a failure unless he or she uses this soap or shaving cream, drives this automobile, owns this radio, sees this movie or play, eats this food, wears this collar, takes this trip or reads this newspaper. *This continual pressure relentlessly applied subjects our working-class population to a strain which they cannot withstand*, nor could we in their places."[21] Many of these people cannot resist the temptation to buy under these conditions, and consequently become easy prey for the high pressure salesman with his E. Z. TERMS.

Increased Real Incomes of the Working Classes.—When looked at from the side of the demand for goods on instalment terms, a very real factor in the instalment movement is to be found, we believe, in the increase in the incomes of the wage-earning classes of the last few years. Professor Alvin H. Hansen finds that real wages in 1925 were from twenty-five to thirty per cent above the prewar level.[22] Professor Paul H. Douglas, in a study of the "Movement of Real Wages," found that in 1924, employed wage-earners in manufacturing and transportation industries, certain clerical groups, ministers, teachers and others, on the average could purchase twenty-seven per cent more goods in 1924 than they could in the 1890's, and, for our purposes, the significant part of the conclusion is that by far the greater part of these gains were secured from 1920 to 1923,[23] the very time in which instalment buying in large volumes began.

As to whether this increased income helped to cause the extension of the instalment system, we cannot say, but it certainly helped to make it possible. The increased income meant that people could buy and pay and consume more than formerly on any terms of sale. Other forms of merchandising such as mail-orders and cash-and-carry purchases have also greatly increased in the past few years.[24] If the people chose to buy and consume and pay so largely on the instalment plan, there was no reason why they could not do so. Credit facilities were offered them, through the development of finance companies, that were not available formerly, as we shall see presently,[25] and the increased real income gave them more than sufficient purchasing power[26] to meet all their instalment obligations as they came due.

"*Underconsumption.*"—An unusual explanation of the growth of instalment buying which is worthy of notice, has been made recently by Mr. W. T. Foster and Mr. Waddill Catchings.[27] They explain it as an accompaniment of a condition termed by them overproduction or underconsumption. It is contended that people can produce

[21] Billikopf, Jacob, Executive Director of the Federation of Jewish Charities of Philadelphia, and Impartial Chairman in the Men's Clothing Industry in New York City, in *Survey Graphic* for April, 1925.

[22] *American Economic Review*, March, 1925, p. 42.

[23] *American Economic Review*, Supplement, March, 1926, p. 37.

[24] *The Index*, Published by the New York Trust Co., March, 1926; *Public Ledger* (Philadelphia), August 7, 1926.

[25] *See* page 10. It is here set forth that the finance companies made possible the great growth of instalment buying by providing the necessary credit facilities for the extension of the system.

[26] *See* the chapter on "Instalment Buying and Saving."

[27] "Business under the Curse of Sisyphus," *World's Work*, September, 1926, p. 509 ff.; "Instalment Selling and Future Buying," *Nation's Business*, August, 1926, p. 47; *The Christian Science Monitor*, September 15, 1926.

more goods than they are able to buy and pay for, and selling on instalment credit has made it possible to continue production even when people were without sufficient purchasing power to pay cash. It is stated that there is no doubt of our ability, as producers, to create all this wealth that is sold on instalments. There it is before our very eyes—at least three billion dollars' worth already produced and turned over to consumers, in excess of what they have paid for. And there is likewise no doubt of our inability, as consumers, to pay cash for all this wealth. Dealers would not be frantically underbidding each other in their efforts to sell all this wealth on small initial payments, if buyers had enough money to make full payments. The very fact that the business world cannot get rid of what it has already produced, even in years which are regarded as highly prosperous, without persuading the people to mortgage their incomes further and further into the future, is conclusive proof that the flow of money to the people who want to buy goods does not keep pace with the flow of the goods. The writers view the phenomenon of instalment buying as evidence in support of their theory that in a period of prosperity industry turns out more consumers' goods than consumers can buy with their incomes. They look upon instalment buying as a logical result of this condition of overproduction because it enables production to be continued at least for the time being even though the consumers do not have the purchasing power to pay for the goods which they are buying.

Liberty Bond Drives.—The opinion was expressed recently by the head of one of the very large finance companies that the instalment plan of purchasing Liberty Bonds through systematic saving "undoubtedly" was "largely responsible for the great increase of miscellaneous instalment buying of all kinds since the war."[28] It is very reasonable to suppose that the selling of government bonds on instalments to a large number of people was a contributing cause to the rapid growth of the instalment system since the war, but to say it was "largely responsible" would seem to be an overstatement of its influence, in view of the various other very probable causal factors.

III. THE CLASSES OR GROUPS OF PEOPLE USING INSTALMENT CREDIT

Poor and Irresponsible People.—Previous to the recent expansion of the instalment system, buying on the instalment plan, except houses and insurance, was practiced almost entirely by poor people. Not only were the people poor, but sometimes they were the least responsible individuals of the community. Under these conditions, losses to the dealers were great, and consequently the prices charged for the credit so high that only those people bought on these terms who could not possibly make any other arrangements. Up until about ten years ago, there was strong social disapproval of the practice—it was looked down upon, and there is still a certain social stigma attached to buying clothing on time. It is only within the last five years that instalment buying has become a respectable thing to do.

[28] Duncan, A. E., Chairman of the Board of Directors of the Commercial Credit Company, Baltimore, Maryland, *Public Ledger*, July 21, 1926.

Poor people continue to purchase on instalments, and the following statement by the president of a large clothing stores organization referring to experiences within his own establishments would indicate that there are still irresponsible buyers among them: "We find that such employes who have contracted the habit of instalment buying can be classed under the head of 'floating' help. Their services at best are uncertain, and the extravagance manifested in the purchase on time payments of personal luxuries is reflected in a general lack of reliability."

Poor, Middle Class, Well-to-do, and Very Rich People.—At the present time, instalment buying is not by any means confined to the poorer classes. Indeed, all economic groups, except very rich people who do not bother with the system, are using it on an extensive scale. However, it is the judgment of those connected with the business that the proportion of the various groups using it is much larger for the lower income groups. From conversations which we have had with numerous consumers as well as with retailers engaged in the instalment business, we believe that there is a marked tendency for lower salaried and even well-to-do people with comparatively large incomes, but who anticipate larger incomes, to buy on deferred payments.

A study was made recently to ascertain the approximate proportion of heads of families using instalment credit in a city of 60,000 people.[29] Five hundred and thirty-two families were canvassed, living in forty-one residence square blocks and constituting a sample of the classes of the entire population. Of these families, ninety-three, or seventeen and five-tenths per cent, made use of instalment credit for purchases of varying amounts, exclusive of insurance and real estate, which ranged from twelve dollars to fourteen hundred and twenty-five dollars.

It was found that forty per cent of the families canvassed in the poorer part of town bought on the instalment basis; twenty-five per cent of those canvassed in the middle class sections of town bought in this manner; and five per cent of the well-to-do families used the system.

This special study confirms the general belief that all classes are buying on instalments, but that the percentage of the various classes using the plan is greater for the lower economic groups.

The extensive use of the system by other than the poorer classes is evidenced by the fact that instalment selling of furniture is practiced by stores dealing with a high class clientele; also that whereas formerly only cheaper jewelry was sold on instalments now expensive articles are sold in this manner and the number of high-grade jewelers selling on deferred payments is steadily increasing. Only three or four years ago, the higher priced cars were sold on time-payments very quietly, but now it is reported that "as many of the expensive products of the General Motors Corporation as of their cheap cars are sold in this way."[30] In addition to expensive automobiles, this company sells electric refrigerators, the prices of which are such as to indicate that they are not bought, for the larger part, by poor families.

City and Country, East, West and South.—Everyone knows about the wide extent of instalment selling in the large cities, but there is a sort of general assumption that the "thrifty and honest farmer" is not being "enmeshed" in this "new and inviting system of

[29] Wolfe, F. E., and Amende, H. F., "The Instalment Plan," *Credit Monthly*, September, 1926.

[30] Rodd, F., *The Economic Journal*, June, 1926, p. 207.

buying more than one can afford to pay for." However, we are told that an investigation of several Mid-West and Southern states showed that the farmer has been the target of an equally vigorous selling campaign and that he too is buying on these terms. In a number of instances county agricultural agents have seen fit to warn farmers against the plan. In addition to tractors and other equipment, the farmers, like other people, are buying automobiles and various smaller articles on time. In California, where the proportion of passenger cars to inhabitants is as one is to three and four-tenths compared with one is to seven over the country as a whole, the deferred payment system is not only in wide use but the keen competition for further business has made it difficult to sell a car except on eighteen months credit as compared with the usual term of twelve months. While instalment buying is found in the rural districts of all parts of the country, it may be true, as is commonly supposed, that there is more of it in the large cities, that is, when considered in relation to population or income. The Federal Reserve Bank of Boston, which is receiving regular monthly reports on instalment sales from leading New England department stores, says that from their experience, the larger increases in instalment business have been in the large cities, and that in the smaller towns and smaller stores this means of granting credit has not had such exceptional growth.[31]

IV. THE CHARACTER OF THE GOODS BOUGHT ON THE INSTALMENT PLAN

What Are the Articles Purchased on the Instalment Plan?—On account of the importance usually attached to the character of the goods bought on the instalment plan by those inquiring into the soundness of the instalment system, an effort has been made to find out what articles are actually most widely purchased on instalment terms. After giving the information gathered on the subject, an analysis of the goods with respect to their character and the use to which they are put will be attempted. Are they producers' or consumers' goods? Durable or quickly consumable? Necessities or luxuries?

Aside from houses, life insurance, and stocks and bonds, all of which are bought on instalments on an extensive scale, the principal items purchased are contained in the following list. They are arranged in the order of their importance as determined by the estimated volumes of credit outstanding at a given time on account of the sale of the various commodities.

1. Automobiles
2. Household Furniture
3. Pianos
4. Sewing Machines
5. Phonographs
6. Washing Machines
7. Radio Sets
8. Jewelry
9. Clothing
10. Tractors
11. Gas Stoves
12. Electric Refrigerators
13. Vacuum Cleaners
14. Farm Equipment
15. Improvements to Buildings

The authority for selecting these commodities as the principal ones and omitting others as relatively unimportant is, first and foremost, the

[31] Correspondence, Warren, R. A., Manager Industrial Statistics Division, Federal Reserve Bank of Boston, June 16, 1926.

results of the investigations of the Economic Policy Commission of the American Bankers' Association, which have not been published but parts of which have appeared in print in various places; second, a questionnaire sent out by the School of Business Administration of the University of Oregon to 2105 consumers residing in all parts of the State of Oregon; third, the results of an investigation by the Farmers' Loan and Trust Company of New York; and fourth, the writer's own correspondence and conversation with the officials of stores and dealers of all kinds doing a large instalment business in many different kinds of goods. There is quite general agreement among these various sources. Wide publicity is given to statements that instalment selling has been extended to the point where any commodity may be purchased on this plan. This may be true except for the products of the illegal liquor business which it is said may not be bought on any other terms than cash. At the same time, *the total volume of sales of articles other than those mentioned is exceedingly small in comparison with the total volume of instalment credit outstanding at a given time*, being only one-hundredth of one per cent according to the results of the investigation of the American Bankers' Association referred to above. If one wished to extend the above list to include some of the articles next in importance, he could add books, furs, typewriters and motor cycles. Automobiles, standing far out and above all the other commodities, account for more than fifty per cent of the total instalment debt outstanding at a given time—more than all the rest of the commodities put together; household furniture comes second with approximately nineteen per cent; and pianos third with approximately seven per cent.

Distinction between Producers' and Consumers' Goods.—Wealth, as economists commonly use the term, is the collective name applied to goods, such as food, clothing, furniture, kitchen utensils, houses, automobiles, raw materials, tools, machinery, buildings, roads, etc., things which are material, scarce, useful, transferable, and which are necessary for the well-being of individuals and of society as a whole. The well-being of a society depends not only on the size of the social fund of such goods but also on their character. It is for this reason that in the analysis of a portion of wealth such as we are making, a useful distinction may be made by the use of the terms consumers' goods and producers' goods.

Wealth in such form that it is ready to gratify the wants of individuals immediately and directly, such as the clothes people are wearing, the furniture they are using in their homes, the houses they are living in, etc., is called consumers' wealth or goods. Other wealth is in a form in which it may be used indirectly to satisfy human want. It is used, not for its own sake, but to help create other wealth or personal services. It includes the instruments of production and the goods in process of production. Examples are motor trucks, passenger cars in productive use, machinery of all kinds, factory and store buildings.

Importance of the Distinction between Producers' and Consumers' Goods.—The advantage of a stock of producers' wealth lies in the fact that it makes labor more productive. Without tools and machinery or with a comparatively small supply of this form of wealth a people would lead a miserable hand to mouth existence. A large and increasing stock of producers' goods increases the prosperity of a people. Producers' credit has long been accepted as a most useful device as it

allows persons who own wealth, but who, on account of their ordinary occupations or from lack of ability, or for other reasons, cannot use it in a productive manner, to place it in the hands of those more able to employ it efficiently in production. The granting of instalment credit for production purposes meets with little or no criticism.

It is the granting of instalment credit for the purchase of what are generally classed as consumption goods that has brought forth severe criticism. Some people oppose it on what seems to be moral grounds. They will tell you that there is nothing wrong with borrowing to carry on one's business, but buying consumers' goods before one has the money to pay for them is not right. It is a practice in most cases so inexcusable that it is, at least in a sense, morally wrong. There are many people including some economists who contend that credit for the purchase of consumption goods should not be extended for important economic reasons. They condemn it on the broad social and economic grounds that it is a detriment to the source of wealth, that is, it increases consumption, thereby decreases saving and thus tends to use up the social fund of wealth or keep it from increasing as it otherwise would. As will be seen later, *we take certain exceptions to the assumption that consumers' instalment credit is a detriment to the source of wealth.*

This criticism of consumers' credit is an old one, but as we shall point out is not entirely applicable to present day consumers' instalment credit. Seventy-five years ago, a distinguished economist set forth the objection to consumers' credit as follows:

> Credit given by dealers to unproductive consumers is never an addition, but always a detriment, to the sources of public wealth. It makes over in temporary use, not the capital of the unproductive classes to the productive but that of the productive to the unproductive. If A, a dealer, supplies goods to B, a landowner or annuitant, to be paid for at the end of five years, as much of the capital of A as is equal to the value of these goods remains for five years unproductive. During such a period, if payment had been made at once, the sum might have been several times expended and replaced, and goods to the amount might have been several times produced, consumed and reproduced: consequently B's withholding 100 l. for five years, even if he pays at last, has cost to the labouring classes of the community during that period an absolute loss of probably several times that amount. A, individually, is compensated, by putting a higher price upon his goods, which is ultimately paid by B: but there is no compensation made to the labouring classes, the chief sufferers by every diversion of capital, whether permanently or temporarily, to unproductive uses. The country has had 100 l. less of capital during those five years, B having taken that amount from A's capital, and spent it unproductively, in anticipation of his own means, and having only after five years set apart a sum from his income and converted it into capital for the purpose of indemnifying A.[2]

Some Consumers' Credit Leads to Increased Production.—While the above statement is true and the reasoning sound, the argument rests upon certain assumptions which are questionable under modern conditions. One should beware of any generalization that instalment consumers' credit is always, or even in most cases, a detriment to the source of wealth. The problem of consumers' credit as it exists at the present time is different from the one presented and worked out in a number of important respects. As we have seen, a certain part of the total volume of instalment credit is extended for the purchase of sewing machines, washing

[2] Mill, J. S., *Principles of Political Economy* (1915 edition), pp. 513-14.

machines and vacuum cleaners. It is generally accepted that approximately seventy-five per cent of all washing machines, sixty-five per cent of all vacuum cleaners and by far the larger part of all sewing machines are sold on this plan. These goods, generally classed as consumers' goods, are labor saving devices, and by freeing the workers in the home from a certain amount of drudgery, release productive effort for other purposes. For example, if by working without any labor saving devices it takes the woman of the home a whole day to do the family washing, and if it takes only one-half day with the washing machine, the possession of which in some cases is possible only by an instalment system, then the individual has saved a half-day's time which may be used in furthering production as a scrub woman, factory worker, sales person, charity worker, political helper, or in the production of some other kind of wealth or service. The loan for the purchase of a family washing machine is usually classed as a consumers' loan and yet the net result of the use of the machine may be, and sometimes is, an increased total production. When such is the case, and the purchase of the machine is possible only through a loan, then the consumers' loan should not be condemned as a detriment to the source of wealth, but rather should be credited with being an aid to increased production. This is not an isolated case but is characteristic of a great deal of instalment buying among poor people.

Still Other Consumers' Credit Is Not a Detriment to the Source of Wealth.—There are still other large quantities of consumers' instalment credit which in their effects upon production and consumption are entirely different from the case presented from the writings of Mill, which was without doubt typical of the consumers' credit of his time. At the present time, the users of consumers' credit in many cases are also lenders for production purposes. At the very same time that they are buying on the instalment plan and using consumers' credit, they are granting producers' credit to others through savings accounts, life insurance reserves, and industrial bond holdings. The present situation is often as follows: the individual has a savings account or life insurance with a cash value of much more than enough to buy a radio set. He wishes to buy a radio set for seventy-five dollars. He could avoid a consumers' loan by withdrawing seventy-five dollars of his savings from productive use and paying cash. In some cases he would actually do so if the commodity could not be had on any other terms than cash. But wherein would this be different, as far as its effects upon production and consumption are concerned, from letting his savings remain in productive use and buying the radio set on the instalment plan which would be contracting a consumers' loan?

The following true illustration will bring out the point we are making that some consumers' instalment credit is not at all a detriment to the source of wealth. A gentleman told us that he started from his country home to buy a certain make of washing machine for one hundred and fifty dollars cash. On his way to town he stopped at a sale of thoroughbred cattle and there saw the opportunity to buy a young Jersey calf which particularly pleased his fancy for one hundred and twenty dollars cash only. Without hesitation he decided to buy the calf for cash and the washing machine on instalments with a down payment of thirty dollars. If the washer could not have been bought on credit, he would have bought it for cash. He contracted a consumers' loan simply and

solely because he wanted to put his funds to a more productive use. Was this consumers' loan a detriment to the source of wealth? Suppose he had paid cash for the washer and bought the calf on credit, would the producers' loan have been a detriment to the source of wealth?

A question involving somewhat the same point might be asked thus: "What is the difference, as far as the increasing of production is concerned, between taking funds directly out of one's business to pay cash for a pleasure car and then replacing the money in the business by a producers' loan, and not disturbing the business at all by buying the car on instalments?" In the first case a producers' loan made possible the sale of an automobile; in the second case a consumers' loan made it possible. In both cases the amounts loaned would be the same, the wealth engaged in production would be the same, and the wealth being consumed would be the same. *It is not the consumers' loan, as is sometimes assumed, that is a detriment to the source of wealth, but the consumption of wealth itself.* If one could say that the consumption of the car would not have taken place if it had not been for the consumers' loan, and that the purchasing power which would have gone for the car would have been saved and used productively, then the consumers' loan was a detriment to the source of wealth. But this assumption is contrary to fact in many, if not in most cases. Some people who buy automobiles on the instalment plan could and would buy them if there were no instalment system. And many of those who would not buy them if they were sold for cash only, could not do so simply because their purchasing power had been used for other consumption goods such as theatre entertainment, food, clothing, and other things bought on cash terms. It is saving and the employing of the savings productively that increases wealth and it is the increased consumption of wealth that is a detriment to the source of wealth. In our present credit system, where many instalment buyers are engaged in business with their own wealth and others are lenders for production purposes and borrowers for consumption purposes at the same time, credit may not necessarily have anything to do with decreasing or increasing consumption in individual instalment transactions. As was explained above, a serious objection raised against consumers' instalment credit is the one that it is a detriment to the source of wealth, that is, it directs goods from productive to consumptive use, thereby it increases consumption and tends to dissipate the social fund of savings or to keep it from increasing as it otherwise would. In analyzing particular instalment transactions, however, this objection loses much of its weight, as we found that in individual cases, which are characteristic of great volumes of instalment buying, consumers' instalment credit does not increase consumption at all and in others it actually increases production.

Motor Trucks versus Passenger Cars as Credit Risks.—Another feature of present-day instalment selling that tends to break down the dividing line between producers' and consumers' credit is the one that instalment credit for the purchase of motor trucks has been found by actual experience to be a less desirable credit risk than that for passenger cars. In the beginning of the recent expansion of the instalment system, it was believed by everybody that the truck being used for production was a more desirable credit risk than the pleasure car. Some of the most important finance companies now in existence were required by their bankers in the earlier stages of the business to handle a definite proportion

of truck paper along with the passenger car paper which was more freely offered.[33] Sometimes more liberal credit terms were granted in the sale of trucks than in the case of passenger cars. The situation in regard to truck paper has been reversed. It may be that a feeling of pride made the family keep up the payments on the car; a great deal of explanation to the neighbors or friends is necessary when an individual "sells" his car two or three months after he has purchased it. But whatever the reason for the situation, it is a fact that, instead of truck paper being the preferred risk, as was at first expected, a number of banks have reversed their former position and now object to the handling of truck paper by their finance companies. This resulted in truck paper becoming a drug on the market for quite a while and it eventually forced the leading truck manufacturers to organize and operate their own finance companies.[34]

Producers' or Consumers' Goods?—Are the commodities most widely purchased on instalments production or consumption goods? In considering the first article on the list, automobiles, one would say that undoubtedly motor trucks (eighty per cent of which are sold on instalments), motor buses, and taxicabs are producers' goods; also passenger cars when used for business purposes. This would include passenger cars when used by business and professional persons in carrying them to and from their places of business. There is no way of telling what proportion of passenger cars are production goods, as in many cases the same car is used in production by the owner in carrying on his business in the daytime and for pleasure in the evening and on Sunday. We believe the part that passenger automobiles play in production is larger than one ordinarily thinks, as they are apt to be thought of as consumption goods when of course this is not necessarily the case. Tractors, farm equipment and part of the improvements to buildings should also be classified as producers' goods. Except the articles just mentioned, all the others enumerated above, eleven out of a total of fifteen, and including household furniture and pianos, the second and third commodities in order of importance, are ordinarily classed as consumers' goods. They are bought for use in the home, and are in the hands of the ultimate consumer. Sewing machines, washing machines, and vacuum cleaners have thus been included under consumers' goods, and they are usually so classed, but it should be pointed out that considered with respect to the use to which they are put, the dividing line between these labor saving devices in the homes and the machines in factories is not very distinct. We have called them consumption goods but they are also very much like production goods.

Durable or Quickly Consumable?—It is a commonplace that all wealth wears out. Some articles of wealth depreciate much more quickly than others and herein some writers see an important consideration in determining the soundness of the instalment system. They say if the life of the good is long, much longer than the term of payments, then instalment buying is a sound practice, but if the good depreciates quickly, and is consumed before the term of payments is completed, the plan is unsound.

Durability is a question of degree and all persons would not classify articles in the same way. Nevertheless, it would seem that with the exception of clothing and possibly automobiles, all

[33] Hanch, C. C., General Manager, National Association of Finance Companies, *American Bankers' Association Journal*, June, 1926.

[34] *Ibid.*

the articles in our former list would fall under the heading of durable goods. Clothing is considered as a quickly consumable good. Automobiles, the most important commodity, is the one most difficult of classification. The fact that most cars are used for a number of years makes them relatively durable goods, but on the other hand some cars depreciate quickly. The constant replacement necessary to keep all automobiles in running condition would seem to indicate that possibly automobiles, or at least some of them, should be placed in the quickly consumable class. In the case of some radio sets, tractors and various farm equipment, a certain amount of replacement to make the goods usable is also necessary after a time. Exclusive of clothing and the doubtful item of automobiles, the remaining thirteen articles are unquestionably durable goods.

Necessities or Luxuries?—One investigator, after securing the opinions of numerous business men, came to the conclusion that,

> Broadly speaking, it seems to us that instalment buying is justified insofar as the purchase of necessities is concerned. . . . Insofar as the acquisition of luxuries is concerned, however, the consensus of opinion would seem to be that that phase of instalment selling which encourages the purchase of such articles is uneconomic and should be discouraged.[35]

Necessities and luxuries are two terms difficult of definition. A rather inclusive definition is one which defines necessities as those goods absolutely essential to the industrial efficiency of the individual. According to this definition, all goods consumed in excess of those necessary to maintain the individual at his maximum industrial efficiency would be luxuries. According to these definitions, the answer to the question as to whether a good is a necessity or luxury would depend entirely upon the individual or the class of individuals under consideration. It would be different for the manual laborer and the professional man, different for the small wage-earning group, the lower salaried group and the higher salaried group. We will not attempt to classify the articles as necessities or luxuries for this reason.

This question could be answered only by a thorough study of the incomes, expenditures and needs of individuals and various social and economic groups. Such a study would probably be practical only by using a sampling method, say by studying the needs of people in a number of city blocks which would include different economic groups using the instalment system. Sections of rural communities should also be studied. After such studies, one would be able to say with some degree of definiteness that washing machines, pianos and mechanical refrigerators were luxuries or necessities to such and such individuals and economic groups. We should find, however, that things regarded as necessities by one individual or some group are regarded as luxuries by another and vice versa. In other words, there are no objective tests of necessities, comforts and luxuries.

In attempting to classify the goods as necessities or luxuries, the point of greatest controversy is the automobile. There are those who believe that automobiles for the great mass of people who own them are pure luxuries, while others believe that the automobile by improving the health of the great mass of people makes them much more efficient workers and is therefore a necessity. Everyone would admit that the motor car is a necessity for the

[35] Instalment Buying, Report of the Farmers' Loan and Trust Company of New York.

physician, and would likewise contend that it is a luxury for the individual who is using one in place of cheaper motor-bus transportation when he does not have sufficient food, clothing and shelter. But whether automobiles are necessities or luxuries for the great number of people who own them one cannot say. It would depend a great deal upon the definition of the terms, and could be answered properly only by a thorough study, such as was mentioned above, into the incomes, expenditures and needs of particular individuals and economic groups using the automobiles.

V. THE FINANCE COMPANY—AN EFFECT OF THE INSTALMENT SYSTEM

The Rise of Finance Companies.—One of the effects of instalment buying has been the bringing into the present system of production a new middleman in the form of the finance company. An almost entirely new field of business has been created which has grown to colossal size within a few years' time. The term *middleman* is applied, because, as will be developed in this chapter, the finance companies stand between the manufacturer and the dealer and between the dealer and the consumer and assist in an orderly productive process. They may also be thought of as middleman on account of the fact that they stand between banks and borrowers. It will be brought out in this chapter and also in the succeeding one that finance companies borrow from banks and lend the borrowed funds to dealers and individual purchasers of goods bought on the instalment plan. The banks themselves are middlemen standing between the investors, a group of people having funds to lend, and another group of people, the borrowers, who have use for the funds. The finance company is simply an additional middleman standing between the original investor and the ultimate borrower and performing certain special services.

The connection between the growth of the organizations which are variously known as finance, credit, discount or acceptance companies and the growth of instalment buying is one of cause and effect interrelationship. The selling of automobiles on the partial payment plan created a demand, as we shall see presently, for some special agency to finance the sales and the finance companies which were organized to supply this need made possible the great growth of instalment buying by providing the necessary credit facilities for the extension of the system. Each new increase in instalment buying reacted to cause a still greater demand for the services of the finance companies with a consequent increase in the size and number of such companies.

A few finance companies had been operating in the discounting of accounts receivable since about 1900,[35] but it was not until about 1915 or a little earlier that they made their appearance in the automobile business. There is some question as to just how rapidly these companies have grown and even as to how many there are at the present time. The estimates of the number at the present time range from 800 to 1700 with "more than a thousand" being a common estimate. It was recently disclosed that there were no less than 111 such companies operating in one of the western

[35] *Federal Reserve Bulletin*, January 1923, p. 37.

cities.[37] These companies have come into existence quickly and some of them are consolidating or going out of business altogether while others are being organized. The fine profits made by the earlier companies caused other companies to be organized quickly. Their operation on the whole has been very profitable. The failures which have been comparatively few have been due principally to mismanagement or to legal defects in the sales agreements.[38] Some of these companies are large organizations doing business on a national scale while others are very small and confine their activities to a single city. One concern starting in 1912 with $300,000 capital, now has $67,000,000 in assets. It is still growing by buying up smaller companies and turning them into branches.[39] Some of these companies specialize in financing automobiles in general or a particular make of automobiles. Others specialize in financing furniture or machinery. And still others deal in paper arising from the sale of any or all kinds of goods. Some of the finance corporations are subsidiaries of the manufacturers for the marketing of whose products they provide credit facilities. Others are subsidiaries of commercial banks. Some manufacturers, when they are in a position to do so, are said to dictate the companies with which the dealers of their products must do business.[40]

The function of the Finance Company: Wholesale Financing.—Finance companies in function are in certain respects like commercial banks, although very few of them are incorporated under the banking laws and subject to regular examination by the state banking departments.[41] It is one of their functions to supply funds to dealers with which the dealers can buy and carry a stock of goods. This activity is sometimes referred to as wholesale financing. They also extend credit on a large scale to individual purchasers of goods bought on the instalment plan. This is sometimes called retail financing. The one service helps the dealer to buy goods, the other helps him to sell them on the instalment plan.

When automobiles began to be sold on the deferred payment basis, the ordinary commercial banks were not prepared and were not willing to perform these functions, at least on the scale that was necessary if instalment selling was to take place in large volumes. Many dealers were doing business on very small capital of their own and they needed financial help to lay in and carry during the winter months the costly stock necessary in this business. They sometimes wanted funds for longer periods than commercial banks were accustomed to lend, due to the seasonal demand for their product. They also wanted to pay back in instalments. The manufacturers were not in a position to give financial aid to their dealers. It is difficult and at times impossible for a manufacturer of automobiles to carry his entire output through the winter months either in his factory or on the sales floor of his dealers. Several years ago it was reported that even the Ford Motor Company found it necessary, due to financial pressure, to "dump" its entire finished stock on its dealers.[42] Since the banks were not

[37] Rodd, F., "The Deferred Payments System in the United States," *The Economic Journal*, June 1926, p. 206.

[38] Norris, G. W., Address before the Fourteenth Annual Meeting of the Chamber of Commerce of the United States, Washington, D. C., May 12, 1926.

[39] Pound, A., "The Land of Dignified Credit," *The Atlantic Monthly*, February 1926, p. 255.

[40] *See* Resolutions, National Automobile Dealers' Association, Chicago, Ill., February 3, 1926.

[41] Correspondence, Cameron, P. G., Secretary of Banking, Commonwealth of Pennsylvania, August 2, 1926.

[42] Hodges, H. G., "Financing the Automobile," *The Annals* of the American Academy of Political and Social Science, November 1924, p. 52.

willing to render financial services and the manufacturers were unable to do so, some agency in the financial structure was demanded which would lend to dealers and to their numerous instalment customers on a large scale, assume the attending risks, make the necessary credit risk investigations and perform the details of supervision and collection.

Retail Financing.—The practices of finance companies in extending credit to individual purchasers of goods bought on the instalment plan are so varied that it is impossible to generalize as to their methods, except in the automobile business where there is uniformity. When an individual buys an automobile on the instalment plan he is usually required to pay in cash at least one-third of the purchase price, and to give a series of promissory notes of equal amounts covering the balance which are due at monthly intervals. Sometimes one note is given instead which provides for a schedule of equal monthly payments. Payments are made over periods of time ranging from three to twelve months or more. The conservative finance companies would like to restrict the instalment credit on automobiles to a period of not more than twelve months. The dealer if he is able to do so sells these notes outright to a finance company and thus in effect receives cash for the goods sold on the instalment plan. When the dealer is able to sell the notes in this manner, his legal responsibility ends, and the business from then on is between the instalment buyer and the finance company. In most cases, however, the dealer is required to endorse his customers' paper and assume the responsibility for its payment. The dealers are against the practice of dealer endorsement and the finance companies are strongly in favor of it. The National Automobile Dealers' Association has protested vigorously to the National Association of Finance Companies against dealer endorsement, but the practice continues.[48]

Some of the finance companies discount the instalment notes in the regular way with banks located in the territory where the notes originate. Others place their receivables in trust with some trust company and issue short-term debentures against the trusteed notes which are sold to banks. Some times collateral trust bonds running for a period of about ten years are sold. In any case, the finance company secures additional funds with which to finance more instalment sales.

Collections of instalment notes when they are due are made sometimes by the finance company and sometimes by the dealer, depending altogether upon the arrangement previously agreed upon by them. Sometimes collections are made by the banks. If the instalment notes are discounted at the bank in the regular way, the original maker of the note is usually notified by the discounting bank to make payments to it direct. The bank in this case is only a collecting agency, however, and in case any instalment is not paid on the day it is due, such instalment is deducted by the bank from the finance company's balance. The finance company then makes its own collections from the delinquent debtor.

The Present Position of the Finance Company in Our Banking System.—The present position of the finance company in our banking system is well stated by the Division of Analysis and Research of the Federal Reserve Board when it says:

> There are in the United States a vast number of companies and individuals whose

[48] Gambill, C. E., President National Automobile Dealers' Association, in pamphlet distributed by the National Automobile Dealers' Association.

resources, or apparent credit risk, do not measure up to the standard required by banks. It is largely these that the finance company is called upon to finance. It does not necessarily follow that such subjects are not good credit risks, but merely that insofar as the bank is able to investigate, they do not fulfill the usual requirements. In addition, payments of the loans made to this class may be spread over a longer period than that for which a commercial bank will advance funds. The payments, too, are probably in small lots, such as instalments, which must be carefully watched and rigidly collected when due. Collateral offered as security is in small lots, such as a group of small accounts receivable. As a result, commercial banks find this class of business unprofitable at the usual rates of interest. If they charged more, it would lead to legal difficulties in some cases, and nearly always to dissension among those borrowers who have to pay the higher rate. Finance companies, however, by dealing only with this class of customers can charge more without causing dissatisfaction among customers. This increased income enables it to carry the investigation further and to protect itself in making a loan, and also to watch developments after the loan is made. *In short, finance companies are an intensified part of our commercial banking system.*[44]

Finance companies are sometimes called "highly specialized commercial banks" because of their likeness to commercial banks in their discounting function, and there is, in fact, great similarity between the two institutions in this respect. However, there is considerable objection to using this expression in describing finance companies. Commercial banking rests primarily on the deposit principle which is not the case with finance companies and on account of this difference, which seems fundamental, some students object to the use of this expression in connection with finance companies.[45]

An Economic Effect of the Finance Company—Equalized Production in the Automobile Industry.—The development of the finance company has had the very desirable economic effect of making possible steady production in an industry the demand for the product of which is seasonal in character. The volume of sales of automobiles in the beginning of the industry was subject to extreme seasonal fluctuations.[46] Due to the increased use of closed cars, the seasonal fluctuations are not so great as they were formerly, but they still exist. If the automobile plant was to be run at its maximum efficiency, it was necessary for production to be equal and continuous the year round. Expensive machinery lying idle part of the time increases unit costs. The importance of steady production in a business with large overhead costs cannot be overstated. Steady production means lower costs to the manufacturer and in the automobile business has meant lower prices to the consumer.

The industry in its beginning was confronted with the difficult problem how to secure steady production to meet a seasonal demand. The manufacturer needed his own capital as well as what he could borrow for manufacturing purposes. Besides, he could not carry his entire output over the winter months for other than financial reasons. He did not have the storage space and even if he could have pro-

[44] The italics are ours. Quoted from *Federal Reserve Bulletin*, January 1923, p. 5.

[45] Dr. W. C. Schluter, University of Pennsylvania, an authority on the subject of the finance company, who has read the manuscript of this chapter, is one of those who takes issue with the statement that finance companies are specialized commercial banks. His contention is that commercial banking is an entirely different business inasmuch as it is based on the deposit principle, which, as mentioned above, is not the case with the finance company.

[46] *See* chart by Prescott, P. B., showing changes in seasonal variations in production of passenger cars, 1910–23, in *Problem of Business Forecasting*, Persons, W. N., Foster, W. I., and Hettinger, A. J., p. 105.

vided such space the problem would not have been solved. Cars must be distributed geographically when the spring demand arises for transportation reasons. As we have told above, the dealer could not take the cars off the manufacturer's hands, because he did not have funds of his own and could not secure them from the regular banks for this purpose. It was the development of the finance company that solved the problem. The finance company extended credit to the dealer, permitting him to lay in his stock as it was finished at the factory. The manufacturer was paid in cash. Production was continuous. Transportation was more easily effected as it was spread over a longer time and the spring rush was lessened. The dealer was able to show his stock on his sales floor and have it ready for immediate delivery to meet the seasonal demand. It was in such manner as we have just outlined that the finance company has helped to bring about a more efficient and orderly procedure in the manufacture, transportation and sale of automobiles.

The Credit Significance of Finance Companies.—Heretofore, business men —wholesalers, manufacturers, etc.— have been the main users of credit. Within the brief period of five or six years, the hundreds of finance companies have discovered and made use of new credit capacity which has never been utilized before. Hundreds of thousands of people, some of whom had scarcely known what credit is, have been brought into the network of the credit system, and are now users of several thousand million dollars of credit annually. This credit is evidenced by legal instruments such as ordinary promissory notes, collateral trust notes and collateral trust bonds which are put on the money market and sold and which are evidences of the increased demand for credit. In the next boom period of the business cycle, assuming that business will continue to fluctuate in the future as it has in the past, instead of an old and somewhat experienced group of business men who will be borrowing more as the boom develops, there will be in addition a whole new group of people, some would say an untried, untested group, who will have borrowed extensively and who will also perhaps be borrowing more. What effect will this have upon the so-called credit strain which accompanies the intense business boom?

One wonders if all or even most of these people realize to the fullest extent the possible woes of the debtor in a period of business depression when his income is reduced or stops altogether. The individual instalment debts are evidenced by notes and legal agreements many of which contain flexible clauses giving large powers to creditors. Heretofore, when the periods of liquidation and depression came, some business men, at the most a comparatively few individuals in the community, have gone into bankruptcy. At the present time, the credit system touches innumerable homes, and one wonders if there will be innumerable bankrupt households enmeshed in the credit system when the next period of unemployment comes. Will the automobile, washing machine and radio be taken away with the neighbors as spectators? Perhaps the family will be allowed to keep the goods, and if so, will it become helpless and subservient before creditors who may prove to be relentless ones?

These questions call up dark pictures, maybe entirely too dark. In a period of depression all instalment buyers will not be out of work, and those who are employed may simply stop buying everything but bare necessities and continue the regular payments in spite

of the reduced income. They would be helped somewhat by the fact that a period of time usually elapses between the crisis and the time when wages begin to fall, thus giving them time to adjust their expenditures to their incomes. Then, too, many instalment buyers are salaried persons whose incomes are fixed for a period of time in advance, thus assuring the individual a regular income until his instalment debts have been paid. The term over which instalment payments extend is usually not a long one, the average being seven or eight months or perhaps less. It is believed by some people that there will be an orderly renewing of credit until the periods of recovery and prosperity come again, when the instalment debtor can and will continue his payments even though in some cases the goods have been consumed. It should be pointed out that if the individual borrowers cannot pay, the finance companies must receive a renewal of credit from the banks. If the banks will not renew loans, and in periods of crisis they frequently will not, what will happen? Will the finance companies have built up reserves when the critical time comes for just such emergency or will they too, like numerous individual instalment buyers, find themselves in bankruptcy?

No one can definitely answer the various questions we have raised. In a discussion later on in our study, we are attempting to consider some of the probable cause and effect relationships of instalemtnt buying on the credit system in the various phases of the business cycle, but the thought we are bringing out here is simply that the finance company has been responsible for bringing into the network of the credit system an army of new credit users and creating a situation which seems filled with possible disastrous consequences to the credit system and to the individuals who may find themselves enmeshed in it. While this is undoubtedly true, we do not mean to imply that finance companies and consumers' credit should be condemned on this account and done away with if possible. Banks and producers' credit are accepted generally as most useful and necessary parts of our industrial organization and yet on occasion they have caused considerable disturbance in our economic life. Credit, that is producers' credit, has been looked upon as being a contributing cause of the extreme fluctuations in business, which constitute what is known as the business cycle, and yet no one suggests that we eliminate producers' credit altogether, simply because of the possible dangers lurking in its use.

VI. THE COST OF CREDIT TO THE INSTALMENT BUYER

The Costs to the Finance Companies and the Retailers Involved in the Granting of Instalment Credit.—Finance companies and retailers are able to extend credit to the individual instalment buyers because they in turn are able to borrow from the regular banks. The finance companies operate largely on borrowed funds, having a borrowing ratio of from three to five times their capital. Some retailers who have well-organized credit departments carry on their instalment business without the service of the finance companies and borrow directly from the banks to finance their instalment sales. One of the costs, therefore, to the finance company or the retailer, as the case may be, is the interest that must be paid to the bank. This rate varies according to

the financial position of the borrower and other factors. The rate on the best types of finance company paper is usually about the same as the best rate on other paper ineligible for rediscount at the Federal Reserve Banks, which is about the same or slightly higher than the rate on brokers' time loans. This means at the present time four and three-fourths to five per cent. The variation in rate between different companies depends entirely upon the judgments of the loaning banks. This variation is probably less than the variation in the rates on customers' loans, and is possibly within three-fourths to one per cent.[47] Retailers pay the same rate for funds when financing their instalment sales as for other purposes, since banks as a rule do not know for what specific purpose the merchant is using the funds he borrows. The rate paid by the retailer to the bank varies from five and one-half to seven and one-half per cent, depending upon the financial position of the borrower and the section of the country.

A second cost is that of a sum sufficient to cover losses in the case of individual buyers who default in payment The losses to the finance companies in handling automobile paper have been very small Very little is known about losses to the dealers. The General Motors Acceptance Corporation has made public its percentages of loss over a period of six years, including the crises and depression period, 1920–21, and the losses are almost negligible. We do not know whether the costs of repossession and resale have been taken into consideration in computing these figures, but if they have not been considered the loss ratio would, of course, be higher than stated.

TOTAL VOLUME OF INSTALMENT RETAIL BUSINESS HANDLED BY THE GENERAL MOTORS ACCEPTANCE CORPORATION AND THE LOSS RATIOS, 1919 TO NOVEMBER 30, 1925[48]

Year	Total Volume of Instalment Business Handled	Loss Ratio
1919.....	$9,989,018	.502 of 1%
1920.....	46,693,170	.918 of 1%
1921.....	39,725,007	.688 of 1%
1922.....	73,608,353	.112 of 1%
1923.....	102,049,475	.061 of 1%
1924.....	102,564,804	.097 of 1%
1925 to Nov. 30..	134,620,627	.012 of 1%

In commenting on the above table, Mr. Alfred P. Sloan, Jr., President of the General Motors Corporation, says that a large part of the losses in the earlier years were due to the fact that they were pioneering in a field where it was necessary to find and train men to fill the positions of branch managers, and that fifty per cent of the losses in 1920 and 1921 occurred in three branches where organization was not matured. Losses similar to those which took place in those offices, he says, could not occur again.

An extensive survey of the losses sustained by finance companies during 1924 showed a loss ratio of less than one-fifth of one per cent on aggregate new and used car paper amounting to $195,500,000.[49] It should be observed that this rate of loss does not show the loss sustained by the dealer. Some of the paper was "recourse" paper, that is, it carried the endorsement of the dealer and in this case the dealer stood the losses, and the finance company lost nothing except in the event of the

[47] Correspondence, Snyder, Carl, General Statistician of the Federal Reserve Bank of New York, August 6, 1926.

[48] *Nation's Business*, April, 1926, p. 18.

[49] The survey was made by Hanch, C. C., General Manager, National Association of Finance Companies.

dealer's default. Other of the paper was "non-recourse" paper, that is, it did not carry the guarantee of the dealer. In 1925, a second extensive survey [50] was made which also showed a small rate of loss by the finance companies on automobile instalment notes. As stated in the case of the other statistics given, we do not know how much, if any, of the cost of repossession and resale is included in these loss ratios.

In many cases the finance companies or the retailers insure their instalment credits with the regular insurance companies engaged in that type of work. The total business of insuring credits rose from $200,000,000 in 1915 to a figure well in excess of $2,500,000,000 in 1925 and a large part of this was due to the expansion of the instalment system.[51] It is estimated that about ten per cent of the notes held by finance corporations are insured as to payment when due.[52] The rates charged for this type of credit insurance vary from ten to thirty-five dollars per thousand, depending upon locality, special conditions and character of goods. The rate is highest where the notes bear only one endorsement and the goods are fragile or not of standard quality. It is lowest where the goods are high class and the notes bear the endorsement of purchaser, dealer, manufacturer and finance corporation. The finance company frequently endorses the note and insures it as to payment when due so that it will receive a higher rating as security for borrowing at the bank. The average insurance rate for automobiles, furniture, machinery, electrical appliances and the like is fifteen dollars a thousand, a rate of less than two-fifths of one per cent. If the notes which are insured are representative instalment notes, the insurance rates indicate a very low rate of loss. One might say that losses to the finance companies are an almost negligible factor in determining the costs of instalment credit, particularly when compared with the total costs which, as we shall see presently, are extremely high.

A third cost is that of making the preliminary credit investigations which are necessary if the credit is extended wisely. There are certain so-called cardinal principles to be observed in the granting of credit which are concerned with the ability and willingness of the debtor to meet his obligations when due, and the observance of these principles by careful investigation of the prospective borrower are just as necessary in the granting of instalment credit as of any other kind of credit. A fourth expense is incurred in the providing of the necessary facilities for making collections on many small notes from numerous customers. There are other costs, particularly those in the nature of overhead expenses, such as the maintenance of places of business and the salaries of officers and general managers.

The Prices Charged by the Finance Companies.—The prices charged by some of the finance companies are extraordinarily high when thought of as a rate of interest on money loaned. These high rates mean that the costs of production which we have outlined above are exceedingly high or the profits of the companies, that is, the difference between their costs and their selling prices, are great. In view of the fact that the finance business is keenly competitive at the present time, the explanation of the high charges would seem to lie in high production costs. There is a great deal of difference in the

[50] This survey was also made by Mr. Hanch.

[51] Rathbone, J., Vice-Chairman of the National Surety Company, New York, *Savings Bank Journal*, May 1926, p. 29.

[52] Smith, E. H., "How Instalment Buyer is Taxed," *The New York Times*, Feb. 14th, 1926, VIII, p. 16.

degrees of efficiency with which individual concerns in general are managed and this is particularly true in this new field of business where new companies are being organized and others going out of business almost every day in the year. Some of the finance companies are of what has been described as a "go-getter" salesman type and others are more like a conservative banking type. It is possible that this new field of the finance business in the main is not as yet efficiently managed. There are undoubtedly big differences in the costs of the various finance companies which mean that some individual concerns are making great profits while others can scarcely keep in business. One of the propositions made by a finance company to a retailer is here given in full. Comment on the plan will be made after it has been presented.

A PROPOSITION MADE BY A FINANCE COMPANY TO A DEALER

"OUR CHARGES"

Our charges for services, including interest, all forms, and so on, vary according to the length of the time over which your customers' instalments run. For example, if they desire to pay the balance due in 12 equal monthly instalments, our service charge is 8 per cent of the face of the note, instalment contract, lease, mortgage, and so on.

The balance owing must in all cases be paid in equal monthly instalments. Our schedule of charges is as shown below:

Balance Payable in	*Our Charge*
4 months	4% of the balance owing
5 months	4½% of the balance owing
6 months	5% of the balance owing
7 months	5½% of the balance owing
8 months	6% of the balance owing
9 months	6½% of the balance owing
10 months	7% of the balance owing
11 months	7½% of the balance owing
12 months	8% of the balance owing

"AS AN EXAMPLE:"

Cash selling price		$68.00
Add 10% for 10 months' time		6.80
Total time selling price		$74.80
Dealer Receives		
Purchaser pays in cash	$10.00	
and gives contract for	$64.80	
You send contract to us and immediately receive 80%	51.84	
Less our charge of 7%	4.54	
You therefore receive from us	$47.30	
You remit first payment to us		$6.48
You remit second payment to us		6.48
You remit third payment to us		6.48
You remit fourth payment to us		6.48
You remit fifth payment to us		6.48
You remit sixth payment to us		6.48
You remit seventh payment to us		6.48
You remit eighth payment to us		6.48
Total remitted to us		$51.84
You keep ninth payment		6.48
You keep tenth payment		6.48
You have therefore received for your machine		$70.26
Cash selling price		68.00
Additional profit to you on time payment plan		$2.26

We do not finance paper running longer than 12 months. We require that at least 10 per cent be paid in cash, as a down payment, at the time of purchase, but our charge is only on the balance owing.

"YOU MAKE COLLECTIONS AS USUAL"

We have found that most dealers desire to collect the deferred payments themselves inasmuch as it results in many of their customers coming to their store to make their payments. While there the dealer has a good opportunity to sell them something else.

Under our plan, we immediately pay you 80 per cent of the unpaid face value, less our charge. You collect the monthly instalments and remit to us on the fifteenth of each month the total amount maturing in that month, whether or not you have collected all payments. When you have sent us monthly payments sufficient to cover the amount due us, including our charge, we return the contracts to you and all future collections belong to you.

The only cost to you is a small fee for your collection privilege, the expense of which can be much more than offset through your increased profit on time sales.

It will be noticed that the charge of the finance company is given as seven per cent, but when the actual time the money is loaned is considered, the rate is twenty-eight per cent per annum which is the usual way of stating interest charges. It will also be noticed that the retailer makes the collections and remits the monthly instalments on the fifteenth of each month, *whether or not he has collected the payments.* The wording of the clause, "whether or not you have collected all the payments," throws the risk entirely on the retailer. *This finance company is receiving a return of twenty-eight per cent without bearing the usual risks of time selling and without bearing the costs of collection.* The rate paid by the consumer in the above transaction based on the amount of money actually borrowed and the actual time for which it is borrowed is thirty-four per cent.

The above proposition of this finance company to the dealer is published in full in one of the current periodicals, with this comment:

Increased competition among the finance companies and the current low interest rates have resulted in a "buyers' market" in instalment sales financing—in other words, the dealers are being offered many different types of "propositions" from among which they can "pick and choose."

If the finance company is asking what seems to be the usurious rate of twenty-eight per cent without bearing the usual risks and collection costs, and the market is characterized as a buyers' market, one wonders what the rate would be in a sellers' market.

An analysis of the charges of one of the very large finance companies was made recently, the results of which are given below. This company has resources of sixty-six million dollars and does a large business extending credit on a blanket plan to dealers selling washing machines, vacuum cleaners, ironing machines, phonographs, typewriters, house-wiring and similar kinds of commodities which can be sold safely on the instalment plan.[53]

After pointing out the fact that the rates to the retailer do not include the costs of risk, the investigator comments:

It would be erroneous to assume that the finance company never takes the risk nor makes the collections. However, for this service they have a separate schedule that averages, for the 10 months' contract, 24 per cent instead of 18.4 per cent as in the above instance; for 6 months' paper, 35.4 per cent instead of 20.16 per cent, and others in proportion. And this, mind you, is not the rate card of a small concern but

[53] The analysis was made by the Marketing Division, Frank Seaman Incorporated, New York City.

RATES CHARGED TO DEALERS BY A LARGE FINANCE COMPANY

(These rates do not include risk-bearing, that is, under these rates, the dealer, not the finance company, bears the loss in case of default by the individual instalment buyer. However, the finance company stands the loss in case of default of both purchaser and dealer.)

Balance Payable in	Rate Finance Company Says It Charges	What the Finance Company Actually Charges	Total Cost of Credit to the Consumer
4 months	4%	22.32%	48.00%
5 months	4½%	21.04	40.00
6 months	5%	20.16	34.27
7 months	5½%	19.52	30.00
8 months	6%	19.03	26.66
9 months	6½%	18.68	24.00
10 months	7%	18.40	21.81
11 months	7½%	18.18	20.00
12 months	8%	18.00	18.45

of an organization with resources of sixty-six million dollars, doing a considerable part of the total instalment business.[54]

The real charges of the finance companies in some cases are not stated frankly and this has led a prominent banker, who is somewhat critical of the instalment system as it is conducted at present, to say:

I feel that it should be fundamental in any instalment selling plan that the buyer be told frankly and honestly just what he is paying for the instalment privilege. A certain plan I have in mind was widely advertised as offering financing for a nine per cent charge. When the charges are actually worked out it is found that the consumer really pays 25.11 per cent per annum on the money he uses.[55]

Sales persons have told us frequently that the difference between the cash and credit prices was a regular bank rate of interest, when the rate actually charged was twenty-five per cent.

The charges of finance companies are not always so high as those just mentioned. Upon making inquiry as a prospective customer concerning the cash and credit prices of a certain make of electric refrigerators, we were quoted prices which indicate a rate of eleven and eight-tenths per cent as the total cost to the consumer. The sale of these refrigerators was being financed by an acceptance corporation operating on a national scale, which was organized as a subsidiary of a manufacturing corporation to finance the sale of its products. It is said that the finance companies which are owned by manufacturers or which have close affiliations with them are able to work on a lower rate than the "outside" companies.

The Price of Credit to the Instalment Buyer.—The price of instalment credit to the consumer, as evidenced by the difference between the cash and credit prices of goods, varies greatly, *ranging from nothing to as much as eighty per cent*,[56] depending upon the individual transaction. Extensive inquiry as a

[54] *Instalment Selling*, Pamphlet, The Marketing Division, Frank Seaman Incorporated, p. 11.

[55] Cheney, O. H., Vice President, American Exchange, Pacific National Bank, New York, in an address at the 14th Annual Meeting of the Chamber of Commerce of the United State , May 11, 1926.

[56] The Case is cited of an established publishing house featuring technical and business books which has a cash discount that makes their terms 84.5 per cent. *Instalment Selling*, Pamphlet, The Marketing Division, Frank Seaman Incorporated, p. 12.

prospective buyer from retailers of all kinds into the cash and credit prices of various commodities, and also examination of the rate schedules of a number of finance companies, indicate to us that the usual price of instalment credit ranges from eleven to forty per cent. Another way of saying the same thing is that, *as a rule, it costs the buyer as much more to buy on the instalment plan, as it would if he borrowed the money at an interest rate of from eleven to forty per cent and paid cash.*

The following are a few cases, typical of the many into which we have inquired. A sewing machine of a well-known make is sold for $83.10 cash and $96.00 on time. The terms are $10.00 down and the balance in monthly instalments of $5.00. This figures up at a rate of approximately twenty-one per cent per annum on the money actually loaned. Another machine of the same company is sold for $117.30 cash and $138.00 on time. The terms are $25.00 down, and the balance in monthly payments of $10.00. This works out at a rate of approximately thirty-six per cent. The financing charges of two competing vacuum cleaners are eleven and five-tenths and twenty-one and eight-tenths per cent respectively. The rate for a particular gas range is twenty-five per cent. The financing charges of a well-known washing machine vary from twelve to forty per cent per annum, depending upon the length of time over which the payments continue. A flat sum of ten dollars is charged for the financing regardless of the length of time, not to exceed twelve months, over which the instalments run. In this particular case, the so-called cash customer is given sixty days in which to pay. This would make the difference between a spot cash price and the time prices quoted above much greater than twelve to forty per cent. These rates are not the actual interest rates charged; they are the difference in rates between money loaned for two months and that loaned for periods of from three to twelve months. The rate of a competing washing machine which has one set of terms only is approximately eighteen per cent.

In all of the above cases interest is charged on interest and at the same rates as quoted for the principal in each case. That is, the interest is assumed to be due when the money is loaned and not when it is paid back. Since the interest is not paid when the transaction is made, it, too, like the principal of the debt, is paid in instalments at the various rates of interest.

To be an instalment shopper it is absolutely necessary for one to be good at figures, otherwise it will be altogether impossible to make any comparison of prices.

The cash and credit prices of house furnishings in some department stores and furniture houses are the same, which might create the impression that one is getting the service for nothing. Such is not the case, at least as a rule; the cost of the credit service is included in a mark-up of prices. There is an advantage to the instalment buyer in these cases, however, as the cash customers are helping to pay the costs of the credit system.

The financing costs of pianos to the individual instalment buyer usually figure up to be low which also might create the impression that one is borrowing cheaply. However, it is thought that the real cost of financing is met by the dealers in a mark-up of prices, the effect of which is to cause the cash buyers to help bear the expense. The cash and credit prices of pianos have frequently been quoted as being exactly the same. In these cases, when the amount involved is quite large, the individual cash pur-

chaser of small means, if he has regard for his economic interests, will overcome his prejudice against the instalment system, if he has one, and use "dignified" credit, as he will gain considerably by so doing. On the other hand, when the difference between the cash and credit prices is twenty per cent, as is quite commonly the case, it would pay the instalment buyer to borrow elsewhere and pay cash. Many instalment buyers do not know what rate of interest they are paying and it may not help them any if they did, as many of them could not qualify for loans at the bank in case they wished to borrow and pay cash for their goods. Undoubtedly, many people pay the seemingly exorbitant rates because they want credit and this is their only way of securing it.

The Price of Automobile Instalment Credit and the Price of Automobiles.—The rate of interest charged in the financing of new automobiles varies from eleven to twenty-three per cent, depending upon the amount borrowed, the length of time for which the money is borrowed, and the company through which it is financed. This is exclusive of any amount which is invariably charged for insurance in favor of the finance company against fire, theft, etc., to protect the finance company's equity in the car. In the case of used cars, the rates vary from sixteen to forty-three per cent per annum of the amount borrowed. These figures have been derived from the rate schedules of the various finance companies.

In considering the costs of credit to the invididual instalment buyer, it should be pointed out that the instalment system has also brought gains to him by causing a great reduction in the price of automobiles. *It is highly probable that the instalment buyer is paying less for his car today than he would be paying as a cash buyer, if there were no instalment system.* Everyone agrees that the introduction of the instalment system increased the sales of automobiles tremendously and made possible production on a much larger scale. The industry in its development has hitherto been subject to the law of decreasing costs to a marked degree and the economies gained by large scale production have been passed on to the customer in the form of lower prices. Each lowering of the price has increased the amount taken and made possible still greater production and still lower unit costs. The price of cars has been reduced thirty or forty per cent since 1913. This fact is all the more remarkable when it is remembered that the general average of prices has risen during this period, and is now approximately fifty per cent higher than it was in 1913. This decrease in price may be attributed to the economies of large scale production, a large part of which have been made possible by the introduction and expansion of the instalment system.

VII. INSTALMENT BUYING AND SAVING

Importance of the Subject.—Saving, as the economist uses the term, means abstaining from the use of economic goods. It means consuming less than is being produced. The savings of the community are to be found in the great stock of wealth, composed of tools, machinery, raw materials, houses, furniture, clothing, food, etc., which is in existence at the present time. According to those who have given the matter thought, the effect of saving, particularly if the savings take the form of producers' wealth, is to increase

the prosperity of the individual and of the community as a whole. Prosperity is assumed to be highly desirable, and since it is dependent so largely upon the size and character of the social fund of savings, any economic phenomenon which seems to affect savings is deserving of careful study. An English writer of thirty years ago reminded the people of his generation that "the world is yet poor"; and that "the total amount of income we, as a community, yet have is so small, that any undue consumption by individuals must put a painful limit, not only to the luxuries but to the comforts and even to the necessaries of the many"; also that "No distribution of income would allow every one to have even those comforts which some of us count necessaries." [87] Notwithstanding the fact that the fund of social wealth has increased greatly during the last few years, and that progress has been made in the arts of production, there may still be necessity for saving as there was thirty years ago.

Instalment Buying Leads to Saving.—Reasoning *a priori*, individuals have come to widely different conclusions in regard to the effect of instalment buying on saving. Business men have frequently advised their employes to go into debt for homes on the ground that they will work harder and save more than they would otherwise in order to meet their financial obligations when they are due. It is also set forth as a reasonable supposition that if the individual is not paying for furniture, vacuum cleaners, and washing machines, he is apt to be spending the odd dollars for theatres or luxuries which are only temporary in their enjoyment. We are reminded that buying stocks and bonds on the instalment plan is simply a systematic method of saving which results in an increase in the stock of material equipment of industry. It is also a fact that if the life of the goods purchased is longer than the period of payment, saving has taken place. If the automobile has been paid for before it is worn out, a saving has taken place, provided, of course, the individual has not taken the money out of the savings account or mortgaged the house to complete the payments on the automobile.

Instalment Buying Is Not Conducive to Saving.—On the other hand, it is stated that the high pressure salesman, with his E. Z. TERMS, causes people to buy and consume things which they could not possess, if they were required to pay cash. Emphasis is placed upon the point that by working on the natural inclination of individuals to possess luxurious articles, the salesman frequently causes the customer to purchase indiscriminately articles of luxury which are quickly consumed. The reasoning is that the instalment buyer soon acquires the luxury habit by being able to possess these articles, and that the luxury habit, thus acquired, leads to spending and consuming rather than to saving. Those who think that instalment buying is not conducive to saving mention frequently the demoralizing effect of too much debt on the individual. A Western banker expresses the ideas of many people when he says, "Wage-earners are mortgaging future earnings for the gratification of present-day pleasures without thought of the morrow that may bring with it sickness or unemployment. Everywhere in the United States instalment-buying is leading our people into a morass of debt that will engulf them unless the dangers of the system are brought before them so forcibly that they will resist the temptation." The condition here described, if it exists, is certainly not conducive to saving.

[87] Smart, William, *Studies in Economics*, p. 300.

The Savings of the Lower Income Groups Examined.—The savings made by people of smaller incomes are evidenced in a number of ways, one of which is the increase in savings bank deposits. The individual deposits his surplus money income in a bank, which in turn lends it to business men who secure with it the necessary wealth and services to expand and carry on business enterprise. The savings are in the form of material equipment of industry. The amount of saving done in this manner, measured in terms of dollars, may be ascertained with some degree of accuracy and we present the following facts for the light they may throw on the problem, when used in conjunction with other facts to follow on insurance reserves, stock and bond holdings, building and loan assets, and the growth of labor banks, all of which furnish information on the condition of personal savings over a period of years. Particular notice will be taken of the figures for the period from 1920 to the present time, as this is the period in which the great extension in instalment selling has taken place.

Inasmuch as the value of the dollar changed greatly during the period of years under consideration, it is necessary to make allowance for such change so that the information brought together may be comparable. Correction for changes in the general level of prices has been made by using the Index Numbers of Wholesale Prices for All Commodities as compiled by the Bureau of Labor Statistics, United States Department of Labor, with the results as given below.

The purpose in assembling the material in this table was to find out if the savings of the country as evidenced by savings banks deposits had been increased or decreased over the period of years 1920 to 1925, inclusive, the

VOLUME OF SAVINGS DEPOSITS, INCLUDING OTHER TIME DEPOSITS, AND NUMBER OF DEPOSITORS IN THE BANKS AND TRUST COMPANIES OF THE UNITED STATES, JUNE 30, 1913–JUNE 30, 1925

Year	Total Savings* Deposits	Total Savings Deposits in 1913 Dollars	Total Savings Deposits in 1913 Dollars Expressed as a Per Cent 1913 = 100	Per Capita* Savings Deposits	Per Capita Savings Deposits in 1913 Dollars	Total* Number Savings Depositors
1913.....	8,548,000,000	8,548,000,000	100	89	89	11,295,931
1914.....	8,711,000,000	8,888,000,000	103	89	90	11,385,734
1915.....	8,807,000,000	8,719,000,000	102	90	89	16,124,786
1916.....	9,459,000,000	7,448,000,000	87	94	74	10,482,832
1917.....	10,875,000,000	6,144,000,000	73	106	59	11,826,773
1918.....	11,534,000,000	5,945,000,000	69	111	57	10,632,938
1919.....	13,040,000,000	6,330,000,000	74	124	60	18,221,453
1920.....	15,314,000,000	6,776,000,000	79	144	63	22,415,148
1921.....	16,500,000,000	11,224,000,000	131	153	104	27,792,948
1922.....	17,578,000,000	11,797,000,000	138	161	108	30,544,738
1923.....	19,726,000,000	12,809,000,000	149	178	115	35,878,758
1924.....	21,188,000,000	14,125,000,000	165	185	123	38,741,634
1925.....	23,134,000,000	14,641,000,000	171	204	129	43,850,127

* *Savings Deposits and Depositors in Banks and Trust Companies of the United States for the years 1912 through 1925*, compiled and published by the Savings Bank Division, American Bankers' Association. The totals include "Postal Savings."

period in which the great extension of instalment buying took place, and also to see if anything else of significance might be inferred from the data in connection with instalment buying. The table shows that from 1920 to 1925, the total savings deposits increased from 6,776,000,000 dollars of the purchasing power of the 1913 dollar to 14,641,000,000 dollars of the same value, which is another way of saying that savings, as evidenced by savings deposits, in 1925 were one hundred and sixteen per cent greater than they were in 1920.

When the savings for these years are considered in relation to a growing population, the results are equally amazing, for they show that the per capita savings measured in terms of dollars of the same value were one hundred and four per cent greater in 1925 than they were in 1920.

In considering the number of savings depositors as given in the table, one must keep in mind that some individuals deposit in more than one bank or at times in more than one account in the same bank, that is, there is an amount of duplication in these figures. However, as this practice existed in 1920 as well as in 1925, the phenomenal increase of ninety-five per cent in the number of depositors in 1925 over the number in 1920, as indicated by the table, can be explained by saying that there was an actual increase in the number of savers, and that this increase probably was a large one.

The fact that the number of savers during this period was so large and that the total volume of savings was increased so tremendously is particularly significant in connection with instalment buying. It means that the masses of the people, those with smaller incomes who were most directly affected by instalment buying, were also savers. It means that while the masses of the people, taken as a whole, were buying, paying and consuming so largely on the instalment plan, they were at the same time saving on an unprecedented scale through the agency of the saving bank.

The condition of insurance reserves is another indication of saving. Through the legal-reserve or level-premium plan of doing business, the insurance companies collect from the

ADMITTED ASSETS, AMERICAN LIFE INSURANCE COMPANIES, 1924–1925

Year	Admitted Assets*	Admitted Assets in 1913 Dollars
1914	4,935,000,000	5,035,000,000
1915	5,190,000,000	5,138,000,000
1916	5,537,000,000	4,359,000,000
1917	5,941,000,000	3,356,000,000
1918	6,475,000,000	3,337,000,000
1919	6,791,000,000	3,296,000,000
1920	7,320,000,000	3,234,000,000
1921	7,936,000,000	5,398,000,000
1922	8,652,000,000	5,806,000,000
1923	9,455,000,000	6,139,000,000
1924	10,394,000,000	6,929,000,000
1925	11,500,000,000	7,278,000,000

* The information on insurance reserves secured through Mr. R. L. Cox, Second Vice-President, Metropolitan Life Insurance Company.

policyholders higher premiums in the early years of insurance than the mortality rates of those years would require, in order that a reserve fund may be established. This fund is then drawn upon in later years to obviate higher and ever-increasing premiums which the increasingly higher mortality rate of the later years of life would otherwise compel. The reserves are invested principally in corporate enterprises and real estate and represent the savings of the policyholders. The "admitted assets" of life insurance companies are an indication of the reserves of those companies, and consequently a measure of the savings effected through the channel of life insurance.

The statistics here given show that life insurance reserves measured in terms of 1913 dollars increased from $3,234,000,000 in 1920 to $7,278,000,000 in 1925. This was an increase of one hundred and twenty-five per cent for the short period of six years. Savings through this agency, therefore, increased at an even more rapid rate than through the savings bank. It is worth noting that nearly all insurance is bought on the instalment plan. The amount which is bought and paid for in a lump sum is very small when compared with the total insurance written. Mention should be made of the fact that approximately thirteen per cent of the life insurance reserves had been loaned to the policyholders on the security of their policies at the end of 1924.[58] That portion of the reserves, therefore, may not represent savings. However, since the practice of borrowing by policyholders was also common in 1920, the figure given above as representing the per cent of increase in savings is not far from correct.

[58] Crocker, W. L., *Nation's Business*, May 1926, p. 17.

The rapid increase, especially among employes and customers, in the number of investors in the securities of corporations is an evidence of saving on the part of the lower income groups. An inquiry [59] into the number of stockholders and bondholders revealed the fact that by the most conservative estimate the railroads, public utilities and other corporate enterprises since 1918 have added at least 3,500,000 stockholders; of which probably 500,000 are employes, 1,000,000 are customers and 2,000,000 are investors drawn from the general public. Also that in addition to the increase in stockholders, on the most conservative basis, bondholders have increased by at least 2,500,000.[60] The American Telephone and Telegraph Company has over 123,000 employes owning stock and a large part was purchased on instalments. By this method 11,000 employes of the Philadelphia Rapid Transit Company bought stock in 1925. The customer ownership policy of the National Electric Light Association has been such that since 1914 over ten million shares of stock in two hundred and twenty-six companies were sold directly to customers and over one-fifth of this volume was paid for in instalments.[61]

These figures tell the same story as the others examined. It is a story of the accumulation of wealth on a great scale by groups of people who were at

[59] Blinkerd, R. S., "The Increase in Popular Ownership Since the World War," *Proceedings of the Academy of Political Science*, April 1925, p. 37.

[60] See also Foerster, R. F., and Dietel, E. H., *Employee Stock Ownership in the United States*, Industrial Relations Section, Princeton University, 1926;
Carver, T. N., "The Diffusion of Ownership of Industries in the United States," *Proceedings of the Academy of Political Science*, April 1925, p. 393.

[61] Haberman, P. W., *Instalment Selling*, pamphlet, an address before the Connecticut Chamber of Commerce, June 1926.

the same time expending huge sums in buying on the instalment plan. The information is particularly significant in this case, as a large part of the saving took place through the means of instalment buying, large volumes of the stocks and bonds having been bought on the instalment plan.

Building and loan associations are a means of saving and the assets of such organizations which are invested in houses are a measure of the savings brought about in this manner.

Upon examining any one source of saving and finding a tremendous increase, one is apt to think that possibly savings have been increased through one channel at the expense of others. Such is not the case, however, as an examination of the various agencies of wealth accumulation shows the same result in each case. In regard to building and loan associations the figures for 1925 are not available at the time this is written, but the total assets in 1924 measured in terms of the 1913 dollar were 3,176,000,000 dollars, which is an increase of one hundred and eighty-three per cent over the amount in 1920, which was 1,121,000,000 dollars of the same value.

BUILDING AND LOAN ASSOCIATIONS: NUMBER, MEMBERSHIP, AND ASSETS

Year	Number of Associations *	Number of Members *	Total Assets *	Total Assets in 1913 Dollars	Total Assets in 1913 Dollars Expressed as a Per Cent 1913 = 100
1913	6,429	2,836,433	1,248,000,000	1,248,000,000	100
1914	6,616	3,103,935	1,357,000,000	1,384,000,000	110
1915	6,806	3,334,899	1,484,000,000	1,469,000,000	117
1916	7,072	3,568,432	1,598,000,000	1,258,000,000	100
1917	7,269	3,838,612	1,769,000,000	999,000,000	80
1918	7,484	4,011,401	1,898,000,000	978,000,000	78
1919	7,788	4,289,326	2,126,000,000	1,032,000,000	82
1920	8,624	5,026,781	2,534,000,000	1,121,000,000	89
1921	9,255	5,809,888	2,890,000,000	1,966,000,000	157
1922	10,009	6,364,144	3,342,000,000	2,242,000,000	179
1923	10,744	7,202,880	3,942,000,000	2,559,000,000	205
1924 †	11,844	8,554,352	4,765,000,000	3,176,000,000	254

* For all years except 1924, *Statistical Abstract of the United States, 1924*.

† For 1924, Correspondence, Division of Statistical Research, Bureau of Foreign and Domestic Commerce, July 1, 1926.

The figures on the number of members in the building and loan associations, as given in the table, contain duplications due to individuals holding stock in several such organizations, but since this practice also existed in 1920, the great increase of seventy per cent in the number of members in 1924 over the number in 1920, as shown in the table, undoubtedly means that there has been a real increase and that the increase has been a large one for the short period of time.

The results in regard to building and loan associations are of interest to us not only because they indicate that saving has taken place, but also

because, as in the case of buying insurance and stocks and bonds on instalments, instalment buying is the agency through which it has taken place. Some of the members of building and loan associations buy paid-up stock, and possibly, in some cases, do not belong to the class of smaller savers, but the membership, as a rule, represents the smaller income groups, and consists of the same class of people taken as a whole who are buying automobiles, radio sets and mechanical refrigerators on instalments.

Still another channel of saving, small in comparison with the others examined, and yet not to be overlooked, is labor banks. The capital of these institutions has been furnished entirely by labor, and instalment selling in many of its phases most directly affects the wage earning classes. The first of these banks was established in 1920, and there has been a rapid increase in the number and capital of these institutions.

Recently a study was made of wage earners' savings in Philadelphia, and although limited in scope, its results are of interest to us, for, as stated previously, instalment buying in many of its phases most directly affects the wage-earning classes. It was found that wage earners' savings in Philadelphia have been "on a materially higher plane than that prior to 1917–18."[64]

LABOR BANKS IN THE UNITED STATES, 1925[62]

Year Founded	Number of Banks Founded Each Year	Total Capital of Banks Founded Each Year
1920	2	1,160,000
1921	2	120,000
1922	4[63]	650,000
1923	8	2,830,000
1924	10	2,125,000
1925	10	2,228,000
	Total number of banks 36	Total capital of banks 9,114,358

Savings and Income.—The above facts prove definitely that considered in absolute amounts the savings of the lower income groups increased at an unprecedented rate. One wonders immediately, however, as to the condition of savings when considered in relation to the income of the same classes of people during the same period of time. If income is increased, there are greater possibilities for saving, and one wonders if savings were increased in proportion to an income which is commonly supposed to have increased

[62] Compiled from information collected by the research department of the Amalgamated Clothing Workers of America, see *The American Labor Year Book*, 1926; see Boeckel, Richard, *Labor's Money* (1923); *Social Progress, a Handbook of the Liberal Movement* (1925), p. 236.

[63] There was a total of six banks founded in 1922, two of which have since been closed. One of those closed, The Producers' and Consumers' Bank, Philadelphia, was closed in 1925 because of "frozen" assets. It has been reopened under another name but it is not now strictly speaking a labor bank, as it is only partly owned and managed by labor.

[64] Schoenfeld, M. H., "Trend of Wage Earners' Savings in Philadelphia," *The Annals* of the American Academy of Political and Social Science, Supplement, September 1925, p. 57.

greatly in recent years. Statistics concerning the income of the lower economic groups for the period 1920 to 1925 are meagre. However, there are some which, while not as inclusive as we would like them to be, are as accurate as can be expected in the present state of researches on this subject. Professor A. H. Hansen finds that real wages in 1925 were from twenty-five to thirty per cent above the prewar level.[65] Professor Paul H. Douglas, in a study on the movement of real wages, found that in 1924, employed wage earners in manufacturing and transportation industries, certain clerical groups, ministers, teachers, government employes and others, on the average could purchase twenty-seven per cent more goods in 1924 than they could in the 1890's, and that by far the greater part of these gains were secured from 1920 to 1923,[66] which is significant for our purposes as this is the time in which instalment buying in large volumes began. A third study finds that the level of real wages of unskilled workmen from 1920 to 1924 averaged fifteen per cent above that of 1913.[67]

If one can consider the increase in income of the groups for which we have statistics, which are certain wage-earning and lower salaried groups, as representative of the increase for the whole lower income and instalment buying group, then the conclusion may be drawn that while incomes were being increased perhaps fifteen to thirty per cent, the savings of the same group were being increased at an even greater rate, very much greater in fact, as we found that savings had been increased by 116 per cent, 125 per cent, and 183 per cent as evidenced by savings bank deposits, life insurance reserves, and building and loan association assets respectively.

Conclusion.—It would be a happy solution of our problem if we could have presented certain definite facts and then, reasoning from cause to effect, stated with absolute certainty that instalment buying taken as a whole tends to decrease, or increase, or has no effect whatever upon the savings of the instalment-buying groups taken as a whole. This could not be done. The conflicting forces which seem to affect and which actually affect savings are numerous. To isolate the single force of instalment buying and study it by observations of controlled experiments is impossible. The actions of human beings are involved and the same kind of instalment buying seems to affect different people differently. For example, it is undoubtedly true that instalment buying causes some individuals to plan their expenditures and thereby leads to saving. But it is equally true that other individuals are led into extravagant spending by the same set of circumstances. If the question as to the effect of instalment buying is definitely answered, it will probably be after long experience with the practice on a large scale. Instalment buying in its present volume has existed for a very few years, and experience with it is too brief to prove anything conclusive in regard to its effect upon savings. Nevertheless we believe that the statistics given above are of some significance when used in connection with the subject.

The facts show that during the years 1920–25, the savings of the lower income groups as evidenced by savings bank deposits were increased one

[65] "Factors Affecting the Trend of Real Wages," *American Economic Review*, March 1925, p. 42.

[66] "Movement of Real Wages and Its Economic Significance," *American Economic Review*, Supplement, March 1926, p. 37.

[67] Coombs, Whitney, *The Wages of Unskilled Labor in Manufacturing Industries in the United States*, 1890–1924, p. 121.

hundred and sixteen per cent; as evidenced by life insurance reserves, one hundred and twenty-five per cent; and by building and loan association assets one hundred and eighty-three per cent. While no attempt has been made to measure the increase in savings as evidenced by the direct investment of employes and customers in the securities of corporations, the facts indicate that saving has taken place through this channel at a phenomenal rate also. The whole labor bank movement, representing a new channel of saving for the wage-earning classes, falls entirely within the period under consideration. Savings have increased not only when considered in absolute amounts but when considered in relation to a growing income as well. The statistics which are available show that the incomes of certain groups of wage earners and certain lower salaried groups increased from fifteen to thirty per cent during the period which we are studying. If these groups for which we have figures in regard to income are representative of the whole lower income group, then it is evident that savings increased at a greater rate even than income.

The period in which these great increases in savings took place is the same as that in which the extension of instalment buying occurred. While the facts do not warrant the drawing of any conclusion whatever in regard to causal relationship between these two phenomena, they do prove conclusively that the goods bought and paid for on the instalment plan during the years 1920–25, taken as a whole, were not paid for out of the savings banks or any of the other sources of accumulation mentioned above. They show more than this; they show that while the huge quantities of goods were being bought and paid for and perhaps consumed only in part, the savings of the lower income groups were being increased at an unprecedented rate. These facts are worth mentioning, as we believe they are such as to reassure, at least for the time being, those who fear that instalment buying will dissipate the social fund of savings. The facts would seem to put those persons on the defensive who are contending that instalment buying is leading us as a people into a morass of debt. If the figures had shown a decrease or a comparatively small increase either when considered in relation to income or in absolute amounts instead of great increases, there would indeed be cause for alarm. The belief is common that instalment buying tends to dissipate savings, and experience over a longer period of years may prove this belief true, but the above pertinent facts which consider instalment buying as a whole and the lower income groups as a whole do not seem to lend any support whatever to this view.

A number of writers fail to see anything reassuring in these figures. They point out that exclusive of houses there are at present goods to the retail value of two and three-quarters billion dollars which have not yet been paid for. Then they ask, "Why should today's saving be affected?" It is certainly true that this two and three-quarters billion dollars is a liability of the instalment buying group. But it is also true that this liability is perhaps more than covered by assets in the form of more or less durable goods, the buying of which caused these people to go into debt. Then, too, even when making allowance for small resale value, that part of the liability which is not so covered is perhaps not a drop in the bucket when compared with the fund of wealth in other forms which has been accumulated during the period of instalment buying and which is

now owned by this same group of people.

The amount of the instalment debt outstanding at the end of 1925, exclusive of houses, is said to have been approximately two and three-quarters billion dollars. In this connection, it should be remembered that during the period of extensive instalment buying, the increase in savings bank deposits alone, just one of the various sources of accumulation examined, was over four billion dollars, more than enough to offset the unpaid instalment debts.

The lower income group between 1920 and 1925 bought and consumed on a great scale. It bought billions of dollars of goods for cash, other billions on instalment credit and still other billions on other forms of credit. But it did not live beyond its income. Even though it consumed so largely goods bought on the instalment plan, the statistics show that there was a net balance of money income over expenditure and instalment indebtedness combined, which assured an unprecedented increase in the social fund of wealth.[68]

VIII. THE EFFECTS OF INSTALMENT BUYING ON THE BUSINESS CYCLE

Producers' Credit and the Period of Prosperity and the Business Boom.—The causes of the rather regular recurring ups and downs of business, which constitute what is known as the business cycle, are somewhat a matter of controversy, but probably most of those who have given the matter thought would agree that credit conditions are an important consideration, particularly in the period of prosperity and in the precipitation of the crisis. "Credit conditions" as a cause of crises and depressions has heretofore meant *producers'* credit conditions, but on account of the extension of the instalment system, consumers' credit is a new force that is being considered as a possible factor in causing future ups and downs of business. At the present time, it is freely predicted that instalment buying will cause the next crisis and depression. A recent forecast in this respect says that,

> A distinct recession in business and possibly a panic within two or three years would not be surprising. . . . It will be the result of overextension of the instalment business, which today is eating into the vitals of business like a cancer.[69]

The exact way in which instalment buying will bring on the next business recession and possible panic is not explained in connection with this prediction, so it is not possible for us to examine the facts and reasoning upon which this specific conclusion is based.

A particular way in which credit has operated heretofore to influence business conditions is through its effect on the general level of prices, which in turn has affected production and brought about a condition known as overexpansion of credit. The truth has long been established through

[68] That part of the chapter "The Character of the Goods Bought on the Instalment Plan" which is included under the sub-headings "Importance of the Distinction between Producers' and Consumers' Goods," "Some Consumers' Credit Leads to Increased Production," and "Still Other Consumers' Credit Is Not a Detriment to the Source of Wealth" is a qualitative discussion of consumers' instalment credit and saving.

[69] Babson, R. W., *The New York Times*, September 12, 1926.

deductive reasoning and verified to some extent by inductive study[70] that an increase in the volume of credit relative to goods produced will tend to cause a rise in the general level of prices or a fall in its reciprocal, the value of the dollar. It is also an orthodox view that a rising price level temporarily stimulates trade, bringing on prosperity and a business boom. However, when the entire stock of material equipment of industry and the available supply of labor are being utilized to their fullest extent, further extensions of credit cannot increase appreciably the total output of goods.[71] The increased credit simply increases the monetary purchasing power, by an increase in bank deposits, which is used in competitive bidding for services and other economic goods already in existence. An illustration of this point may be found in the marked and unhealthy advance in the price of wool in 1919. It is said that this could not have occurred if Boston and other banks had not granted unusual credits to wool dealers. With these funds wool dealers competed against each other for wool, boosting prices to abnormally high levels with consequences painful to themselves and hardly to the permanent advantage of the wool grower. A similar situation obtained throughout the entire industry among makers of woolens and worsteds and among clothiers. All were attempting to handle more business, but the credit secured for the purpose was absorbed in a sellers' market for materials and labor, yielding still higher prices rather than an increased output. As for wholesalers and retailers, the summer of 1920 disclosed holdings of large stocks purchased at high prices, and in very many instances obligations under contracts for abnormally large deliveries in later months. These unhealthy conditions were due to the excessive volume of credit granted by the banks.[72]

The point we are attempting to bring out is that the constantly increasing volume of producers' credit which accompanies the period of prosperity and business boom after a time does not bring about a commensurate increase in production, but simply raises the general average of prices, which brings about undesirable economic consequences. The rising price level, making great profits possible, provides an incentive for enlarging the individual business, and results in competitive bidding of business men for the supply of labor which is already fully employed and for the available supply of materials which is already in existence. The borrowers bid up the prices of services and commodities, and so cause an expansion in the pecuniary volume of trade. However, they produce no corresponding increase in the physical volume of trade. Their borrowings merely increase still more the mass of debts which upon the slightest occasion leads to demands for liquidation and precipitates a crisis.

Instalment Credit and the Period of Prosperity and Business Boom.—It is common practice when an instalment sale is made for the purchaser to give his personal note to the retailer which is discounted with a bank either directly or through the medium of a finance

[70] *See* Working, Holbrook, *Quarterly Journal of Economics*, February 1923, pp. 228 ff.; also see *The Review of Economic Statistics*, July 1926, pp. 120 ff.

[71] *See* Veblen, Thorstein, *The Theory of Business Enterprise*, pp. 92 ff.; Sprague, O. M. W., "Bank Management and the Business Cycle," *Harvard Business Review*, Vol. 1, Number 1 (1922), p. 22; *Business Cycles and Unemployment*, Report and Recommendations of a Committee of the President's Conference on Unemployment, pp. xxv, 26 (Adams, T. S.).

[72] Sprague, O. M. W., "Bank Management and the Business Cycle," *Harvard Business Review*, Vol. I, Number 1 (1922), p. 22.

company.[73] Regardless of who discounts the notes, the proceeds are usually taken in bank deposits which make it possible for the retailer or finance company to finance more instalment sales which give rise to more instalment notes which may in turn be used as a basis for another loan and another increase in bank deposits. In this way instalment sales result largely in an exchange of personal credit for bank credit. It would seem for this reason that the effect of an increase of instalment credit would be precisely the same as that of other bank credit as far as the business cycle is concerned. It would seem that an expansion of instalment credit in a period of depression, if sales are thereby stimulated, would be a very desirable procedure from the point of view of the business cycle. Control of credit expansion so that production is increased to what is regarded as a proper degree, is a principle accepted as sound by all bankers. However, it is also an accepted principle of bankers that credit expansion should be checked when it becomes dangerous. To expand instalment credit in a period of business boom would seem to have precisely the same effect upon price levels, production and overexpansion of credit as the expansion of producers' credit would have. Additional pecuniary purchasing power in the form of bank deposits is created, while a corresponding increase in goods produced is not possible, due to the fact, as stated before, that in a period of intense business boom the industrial army with its full equipment is already at work. The increasing of instalment credit in a period of business boom would, therefore, like the increasing of producers' credit in such a time, help toward the piling up of debts, a condition known as overexpansion of credit which paves the way for crisis, liquidation and depression.

Instalment Credit and the Federal Reserve System.—In current discussions the fear is frequently expressed that instalment selling in such large volumes will obstruct or vitiate the efforts of the Federal Reserve Banks in their attempts to "stabilize the general credit situation"[74] and through this means lessen the excessive peaks and slumps of the business cycle. The time or condition at which further extensions of credit should be discontinued in a period of prosperity will continue to be a difficult problem for banks and business men in the future as it was before the great expansion of the instalment system. But if the Federal Reserve Banks are able, through changing the rediscount rate or by selling or buying government securities in the open market, to stabilize the general credit situation, it would seem that instalment credit, an element included in the general credit situation and at the present time bound up inseparably with it, could be controlled in exactly the same way. The difference between instalment credit and other kinds of consumers' credit, as well as a great deal of producers' credit, as far as the effects on price levels, production and overexpansion of credit in a business boom are concerned, is one of mere quantity rather than one of difference in kind. The fact that debts are paid back in instalments rather than in a lump sum cannot make any great difference. The fact that instalment debts have been contracted for consumers' goods rather than for pro-

[73] Other statements of the way in which bank credit is secured for the purpose of carrying on the instalment business may be found on pages 21 and 24.

[74] An expression used by the Federal Reserve Board. See *American Economic Review*, March 1925, pp. 43 ff.; also *American Bankers' Association Journal*, May 1926.

ducers' goods cannot make any difference, if we are right in our contention that producers' loans also cannot increase production appreciably when the entire supply of labor and equipment of industry are already fully employed, as is the case in a period of intense prosperity or business boom.

The Total Volume of Credit and the Volume of Instalment Credit.—When the estimated volume of instalment credit is given in absolute numbers, as is usually the case, it looks large and *is* large, but when considered in relation to the volumes of other kinds of credit outstanding, many of which, if not all, are liable to influence the business cycle, one realizes that there is a possibility of concentrating attention on instalment credit, one dangerous element in the credit situation, to the exclusion of others equally dangerous.

"What is the total volume of credit outstanding at the present time and how does it compare with the total volume of instalment credit outstanding?" Mr. Carl Snyder, Statistician of the Federal Reserve Bank of New York, in an investigation of the total volume of all kinds of credit outstanding at the present time, has estimated that the amounts known and those which may be estimated which are loaned from one class of people to another in the United States at the present time total something like one hundred and twenty or one hundred and thirty billions of dollars, and in addition to this amount there are large volumes of credit, totaling many billions, which are not estimable.[75] These figures make allowance for duplication, that is, they do not include money borrowed simply for the purpose of reloaning. These loans consist of: first, ordinary bank loans which range from fifteen to twenty billions and at the time of his writing were around twenty billions; second, Federal Reserve loans, an amount which has varied as widely as from nearly three billions to less than two hundred million; third, forty or fifty billions of corporation bonds and mortgages and more than thirty billions of Federal, state and municipal government bonds; fourth, real estate and farm mortgages amounting to something like eight to ten billions of farm mortgages and some fifteen billions or more of urban mortgages; and fifth, there is a large volume of current and casual credit extended by manufacturers, jobbers, retailers and dealers of all sorts to their customers. The amount of this credit is quite incalculable but its volume is large.

No one knows what the volume of instalment credit outstanding is at the present time. It is estimated that exclusive of houses the total instalment debt outstanding at the end of 1925 was approximately $2,750,000,000. This is the estimate which was made last spring by the Economic Policy Commission of the American Bankers' Association,[76] and is the figure used and commonly accepted as an approximation by bankers and others. Since there is much borrowing for the purpose of reloaning in the instalment business, the actual amount owing from certain groups to other groups on account of the instalment business would be much greater than the two and three-quarter billions. From the point of view of the business cycle, all forms of credit are probably not equally influential. Instalment credit is perhaps as in-

[75] Snyder, Carl, "The Influence of the Interest Rate on the Business Cycle," *American Economic Review*, December 1925.

[76] *The Evening Bulletin* (Philadelphia), May 5, 1926; *Credit Monthly*, September 1926, p. 8; Duncan, A. E., "The Economics of Instalment Buying," an address delivered before the National Association of Supervisors of State Banks, July 20, 1926, at Columbus, Ohio.

fluential as any other form of credit, granting our contention as set forth above that an increase of instalment selling in a period of prosperity would react unfavorably by its tendency to raise the average of prices with undesirable consequences; but even so, the observation to be made on the facts is the comparative smallness of the volume of instalment credit—so small, in fact, as to be almost negligible. An expansion of instalment credit in a period of prosperity would seem to be an unwise procedure from the standpoint of the ups and downs of business as it would tend to increase the price level and thus bring on crisis and depression, but to say that instalment credit in itself will be *the* cause of the next crisis and depression, would seem to be an overstatement of the importance of instalment credit as a casual factor. The important consideration for bankers, business men, and all others who would like to decrease the extreme fluctuations of business is the whole credit situation rather than one minor phase of it. Overexpansion of credit helped to cause crises and panics before the instalment system on a large scale had been introduced, and it would be the wise policy to watch the expansion of those older forms of credit which are known to have helped to cause fluctuations in business in the past and which will undoubtedly do it again, as well as this new and potentially dangerous form of credit. The assertion which has been made a number of times by responsible persons that instalment buying will be *the* cause of the next crisis and panic is a bold statement in view of the enormous quantities of other kinds of credit outstanding, the increasing of which, as is known from past experience, would exert strong influences on the business cycle.

At the present time, we are in the prosperity phase of the business cycle, and since it is the *increasing* of credit in this period which brings about undesirable consequences, an important question at the present time is whether instalment selling is on the increase. This is a question of fact and one might think at first glance that it should be answered easily, but such is not the case. It is a very much debated point, because the facts necessary to the settling of the question are not available. For example, it is not known how much instalment paper has been used as a basis for bank loans of various kinds. If this information were available for a period of time it would be exceedingly valuable for our purposes, as it would be some indication of the expansion or contraction of instalment credit. The report of the Economic Policy Commission of the American Bankers' Association, referred to above, contained the results of an investigation into instalment sales for the years 1923 and 1925. The conclusion was that instalment sales had increased seven per cent in the two years' time. This is much less than is commonly supposed to be the case.

It is interesting to note that throughout the period 1920–26, the period in which the great expansion of instalment buying has taken place, there has not been any great increase in the general average of prices, at least as indicated by the index numbers of prices of wholesale commodities as compiled by the Bureau of Labor Statistics, United States Department of Labor, which are shown in the following table.[77]

When one considers that the index numbers show a decline in the price

[77] Source for all statistics except Aug. and Sept. 1926, *Monthly Labor Review*, monthly issues March to September, 1926; for Aug. and Sept. 1926, *The Commercial and Financial Chronicle*, Oct. 23, 1926, p. 2049; for Oct. and Nov. 1926, *ibid.*, Dec. 18, 1926, p. 3104.

Year	Index Number of Wholesale Prices
1920	226
1921	147
1922	149
1923	154
1924	150
1925	158
1926, Jan.	156
Feb.	155
Mar.	151.5
Apr.	151.1
May	151.7
June	152.3
July	150.7
Aug.	149.2
Sept.	150.5
Oct.	149.7
Nov.	148.1

level in 1926 over 1925, he feels that instalment credit is not plunging us headlong into crisis and depression via an increasing price level. However, there may be a possibility that instalment buying may endanger the credit structure by bringing into operation a sequence of events for which there is no precedent in the history of business cycles. An orthodox view has been that an intense boom in a particular industry could develop only under the stimulus of a rise in the prices of its products, and yet the price of automobiles has fallen greatly during the development of the tremendously great boom in the industry. This is easily explained, however, as it is price relative to costs that is significant. Falling costs have had the same effect as rising prices.

The Automobile Industry, Misdirected Production, and the Next Crisis.—Another way, in addition to its effect upon price levels, by which instalment buying may help to cause the next crisis is developing in the automobile industry, a condition known as misdirected production or overproduction as some prefer to call it. The automobile industry is a very important consideration as it is responsible for fifty-four per cent of the instalment debt, exclusive of houses, outstanding at the present time.[78] By misdirected production is meant the building up of a productive capacity and the turning out of a finished product so great in relation to the demand for the finished product, that it is impossible to sell the amount produced at a profit; on the contrary, it is necessary to sell at great loss. As production is carried on in anticipation of demand, such a condition is possible, even very probable, in an industry which is going through a period of intense boom, and in which there seems to exist such great optimism for the future.

Everyone agrees that the automobile business has been built up to its present position as one of our greatest industries largely through the instalment system; also that the maintenance of its position depends almost entirely upon the continuance of the system. Automobile manufacturers and others who venture opinions on the subject say that if automobiles were sold for cash only, the sales would amount to possibly only thirty-five per cent of the present volume. Notwithstanding the fact that the industry is burdened to some extent with unused productive capacity at the present time,[79] the optimistic manufacturers are said to be laying plans for still larger factories and more extensive facilities.[80] While

[78] *The Evening Bulletin* (Philadelphia), May 5, 1926, gives this estimate from the Report of the Economic Policy Commission of the American Bankers' Association. The report itself has never been published.

[79] Gambill, C. E., Address delivered at the Annual Convention of the National Association of Finance Companies, Chicago, Illinois, November 16, 1925; *see* page 7 of this study.

[80] *Public Ledger* (Philadelphia), October 11, 1926 ("General Motors will be the leader in this respect and is launching a $40,000,000 expansion

it is denied in some quarters,[81] there is some evidence to indicate that instalment selling of automobiles is still on the increase,[82] thus furnishing stimulus for further expansion. It is sometimes said that in order to increase sales still further many automobiles are being sold allowing excessive amounts for old cars, and that many are being sold to irresponsible buyers on terms that are too easy, that is, the down payments are too small as judged by more conservative credit standards and the term over which payment is made is too long. Just how much basis in fact there is in these charges, one cannot say. At any rate, the automobile industry has been expanding rapidly and continues to do so, and if the leaders of the industry should for any reason whatever misjudge the future demand, the automobile plants would have to restrict output or close down altogether. If this should occur, the consequences would undoubtedly be disastrous for the automobile industry. We have stated elsewhere that the business has been subject to the law of increasing returns to a marked degree, and have recounted how this has reacted favorably in the development of the industry. However, in case it is necessary to restrict output, the reaction would be most unfavorable. The unit costs will be increased due to the spreading of the overhead expenses over a fewer number of units. The increased cost will mean higher prices and less cars sold and consequently still higher prices with less and less sold.[83] The danger point in the situation lies in the fact that if the motor boom should collapse in any way, it may and probably would be followed by a collapse in some of the industries dependent upon the motor industry, and from these it would spread to industry generally. The automobile industry uses eighty-four per cent of the products of the rubber industry, fifty per cent of the plate glass industry, eleven per cent of the iron and steel, sixty-five per cent of the upholstery leather and millions of pounds of cotton fabric, and billions of gallons of gasoline, and furnishes the railroads 3,040,000 carloads of freight annu-

program that covers additional factory facilities and new equipment").

Ibid., November 20, 1926 ("Leading manufacturers of the automobile industry are of the opinion that within the next few years 40,000,000 cars will be in owners' hands." The number at the present time is slightly in excess of 22,000,000).

[81] Correspondence, Hanch, C. C., General Manage , National Association of Finance Companies, July 13, 1926 ("There has been no increase in the instalment sales of automobiles for two or three years");

The Economic Policy Commission of the American Bankers' Association found that there had been no increase in instalment selling of automobiles from 1923 to 1925.

[82] The Federal Reserve Bank of Philadelphia has been receiving reports from fifteen distributors of automobiles in the Philadelphia reserve district, and the compilations of these reports which have been published in *The Business Review* for July, August, September and October, 1926, indicate that retail instalment sales, considered according to number of cars in May, June, July and August, 1926, were 8.9 per cent, 10.3 per cent, .9 per cent and 45.8 per cent greater than those of the corresponding months of 1925. Considered in respect to the value of cars sold on the instalment plan, the per cent of change in May, June, July and August, 1926, from the corresponding months of 1925 was respectively +8.6, +33.3, −1.0, and +16.4 per cent above those of 1925;

Correspondence, Reeves, Alfred, General Manager, National Automobile Chamber of Commerce, July 9, 1926 ("In 1925 approximately 75 per cent of all cars in the United States were sold on the deferred payment plan. In 1924 approximately 70 per cent and in 1923 about 65 per cent were sold by the instalment method. These figures are estimates but we believe they fairly represent the facts").

[83] There is another possibility: "Is it more likely that prices would remain low, due to the depression of the industry, until the weaker producers were forced out? Then the larger producers would be able to run at capacity, with low costs."

ally.[84] It is also a major factor in the support of fire, theft and casualty insurance companies, as well as finance companies and banks. The seventy-nine automobile plants and accessories factories employ 234,000 persons at the present time,[85] and there are 2,584,232 persons directly and indirectly in the industry.[86]

The automobile industry may not help to cause the next crisis and depression by developing the condition described above as overproduction, but the business ranks with agriculture as our leading industry and it requires no stretch of the imagination to see it overexpanded in relation to future demand. There is optimism prevailing among those in the business and the industry is in the midst of an intense boom. It has been built up by increased sales stimulated by extending larger and still larger volumes of credit. It has now reached the point where seventy-five per cent of the cars sold are on credit. Will it be eighty per cent next year? If for any reason it becomes necessary to restrict credit, the tendency would be for the amount bought to decrease, and this may possibly initiate a collapse such as that referred to above which might bring on a general recession of business.

Instalment Buying, Depression and Recovery.[87]—There are grounds for believing that the next period of depression will be prolonged on account of the instalment selling of the present. The reasoning is that heretofore when the crisis and depression came, there were huge stocks of goods in the hands of retailers, wholesalers and manufacturers which had been produced under high cost conditions, and there was no hope of recovery from the depression until these goods were bought. Since millions of people were unemployed, there was little buying and the larger the accumulated stocks in the warehouses, the longer the period until these stocks were sold. In the next depression, in addition to the merchandise in the hands of the producers which cannot be sold, there may be large quantities of repossessed goods, and still other huge quantities of goods in the hands of the consumers which will not be paid for. When the period of recovery comes the instalment buyers will be making back payments, plus accumulated service charges including interest, which will have mounted sky high as time passed, instead of buying new goods. The flexible clauses in the instalment contracts will, without question, permit the additional charges. But in addition to the difficulty of back payments, the stocks of goods, including the repossessed goods, must be sold before recovery can come and this set of circumstances will cause recovery to be delayed longer than otherwise would be the case if there had been no instalment system. There is no way of actually knowing what will happen but this view of the situation seems a reasonable one.

On the other hand there is the possibility that new extensions of credit will be granted in the latter part of the depression period, which will stimulate sales and hasten recovery. In other words, instalment selling may be the very device for hastening prosperity and lifting industry out of depression just as it is believed to have done in a number of lines of trade, particularly the automobile business in the depression

[84] Hanch, C. C., General Manager, National Association of Finance Companies.

[85] *Public Ledger* (Philadelphia), October 11, 1926.

[86] Duncan, A. E., "The Economics of Instalment Buying," an address delivered before the National Association of Supervisors of State Banks, July 20, 1926.

[87] Some of the probable effects of the next depression on instalment buying are also discussed on pages 23–4 of this study.

of the latter part of 1920 and the year 1921.[88] In fact, it seems logical to believe that if instalment selling were expanded in a period of depression, thereby increasing sales and encouraging production, it could be looked upon as a most useful agency from the standpoint of the business cycle. It would certainly seem, from the viewpoint of lessening the fluctuations of business, that the desirable procedure would be to expand instalment credit in a period of depression and restrict it in a period of prosperity and business boom. This, of course, is easier said than done, as keen competition existing between banks, between finance companies, between manufacturers, and between dealers in different kinds of goods as well as the same kinds of goods [89] makes the restricting of instalment credit in a period of prosperity very difficult. Wide publicity has been given to the broadsides delivered at instalment buying by several prominent individuals, automobile manufacturers and bankers, who are engaged in the practice themselves on an extensive scale. "It is being overdone," "It has gone too far," they say, and one wonders if they, in their respective business units, are decreasing the volumes of instalment sales. The instalment business has been, and is at the present time extremely profitable for these groups of business men, and which of them will put his foot on his instalment business and see it go to his competitor? For the exercise of control over the expansion and contraction of credit, one looks to the banking system—the banks as individual institutions as well as the Federal Reserve System. If the Federal Reserve Banks are able to control the general credit situation, as they are trying to do, and if they are wise enough to know the time or condition at which further extensions of credit should be discontinued in a period of prosperity, it would seem that instalment selling under such control might be a most useful device for lessening the extreme fluctuations of business. However, there is no getting away from the fact that instalment credit, like the older forms of credit, is a potentially dangerous phenomenon which without control will tend to help cause crises, panics and depressions, just as the older forms of credit have done heretofore.

IX. THE EFFECTS ON THE INSTALMENT SYSTEM OF THE STRIKE IN THE ANTHRACITE REGIONS OF PENNSYLVANIA

Selling on the instalment plan assumes a regular income on the part of consumers. For this reason, it is frequently said that as long as people are employed, the instalment system will run smoothly, but when unemployment comes, the instalment debtors may be harassed by their creditors and the instalment sellers may be forced into bankruptcy. In this connection, the experience of the anthracite coal mining district of Pennsylvania during the strike which occurred there from September 1, 1925, to February 14, 1926, is worth considering. We are not attempting to generalize in any way on the basis of the experience of the anthracite regions; that is, we are not attempting to say what would happen in case of nation-wide unemployment such as occurs in

[88] *See* page 6 concerning *Excess Productive Capacity* as a cause of *The Growth of Instalment Buying.*

[89] *See* page 7 concerning *Competition* as a cause of *The Growth of Instalment Buying.*

a period of general depression. The strike was a local matter. In this territory almost all business activity is dependent upon the operation of the mines, and when the strike came, almost the entire community was unemployed for a period of five and one-half months. Information in regard to what happened to instalment buying when the strike came was secured by conversation and correspondence with numerous consumers, dealers of all kinds, finance company officials and bankers living or doing business in the anthracite regions. There is general agreement in regard to the facts given and opinions expressed.

Repossession of Goods or Re-extensions of Credit?—With the exception of automobiles, which we will discuss presently, the fulfillment of instalment contracts on the part of the buyers was postponed until after the strike was over. That is, a sort of moratorium was arranged. All payments were suspended. The customers were allowed to keep the goods. Most of the dealers said they had no more repossessions than they would have had if there had been no strike. When the strike was over practically everyone resumed payments. The case of automobiles was somewhat different. The finance companies repossessed a considerable number of cars and the customers were quite willing for them to do so, as they could not afford to run them. One company says perhaps the larger part of its cars were repossessed. In some cases these cars were taken to other parts of the country and sold. In others, they were put in storage and restored to the buyer when the strike was over under a new financing agreement.

Extra Charges for Re-extension of Credit?—In view of the fact that payments were suspended during the strike, and money was thus owing for a longer period than was anticipated when the goods were sold, inquiry was made as to whether extra interest or extra financing charges were added. In some cases, for example, in the piano business, an extended lease or "raised" contract was made which included interest for the extended period. In the case of department stores, extra charges were sometimes made. In a large number of cases, however, one retailer said seventy-five per cent, the buyers were not willing to pay the additional amounts. When such was the case, no additional charge was made. When repossessed automobiles were redeemed by the buyers after the strike, a new financing contract was written which frequently included payment for storage charges on the car for the period of the strike. In those cases where the buyers were allowed to keep the cars although payments were suspended, sometimes additional charges were made but more often they were not. In the cases where such charges were made, the rate was about the same as on the original purchase.

Losses.—Dealers and finance companies were forced to take losses higher than in normal times. As we have pointed out previously, dealers and finance companies carry on their instalment business largely with funds borrowed from banks. Whether or not the individual buyers paid interest for the additional time of their loans, the dealers and finance companies had to pay such interest at the banks. This was perhaps the main source of loss to retailers. The losses on instalment accounts generally were about the same as on other kinds of credit such as ordinary charge accounts. Several retailers told us that their losses on instalment accounts were less than on their charge accounts. The banks had no losses. They would have suffered

in case of default by dealers and finance companies but the dealers and finance companies were able to stand all losses.

Were the Effects of the Strike on the Instalment System Such as to Give One Confidence in the System?—This is the question that was asked of all those with whom we discussed the subject of instalment buying and the strike. The answers received were invariably to the effect that everything in their experience was such as to indicate that selling on the instalment plan is a sound way of doing business. The strike has been over for almost a year and the same dealers and finance companies are doing business on the instalment plan with the same customers in the same way as they did before the strike.

Did Instalment Debts Have Any Deterring Effect on the Calling of the Strike?—The view is sometimes expressed that debts tends to have a stabilizing effect on workers. It is thought that their respect for obligations or their fear of consequences will make them hesitate to give up their jobs. It was the opinion of everyone with whom we discussed the subject that the instalment obligations of the miners had absolutely no deterring influence whatever on the calling of the strike.

X. THE EFFECTS OF INSTALMENT BUYING ON THE CHARACTER OF THE INDIVIDUAL

Instalment Buying Is Creating a Generation of Spendthrifts.—It is the view of some people that "this system of allowing individuals to buy more than they can pay for" is creating a generation of improvident people—spendthrifts. It is causing individuals to form habits of extravagant spending, rather than the socially desirable habit of saving. The practice of thrift has been a copybook maxim for generations and our parents brought us up to believe that saving is a virtue. There was a time when being in almost any kind of debt was considered somewhat of a family disgrace. Moreover, buying on the instalment plan was considered one of the lowest forms of debt that one could contract—it was looked down upon socially. It was considered an arrangement for persons who were poor, improvident—not able to take care of their own affairs. They needed a collector to tell them under threats how to dispose of their money on pay day. Now what has happened? Respectable people, without any feeling of shame, ride around in motor cars, even expensive ones, which are not paid for. When one's neighbor drives out in a new car, the odds are exactly three to one that he is borrowing from the future, living beyond his means. Respectable people are wearing expensive furs and jewelry, bought on time. Instalment buying has acquired an air of respectability; the automobile is said to be responsible for our looking at this old practice in a new light. It is the opinion of some people that the conditions here described are having a deteriorating effect upon the character of individuals. And what is more important, children are being reared in this environment, and they, not having had lessons of thrift instilled into them, will be economically less responsible than their instalment-buying parents.

Instalment Credit Has a Disciplinary Value—It Inculcates Habits of Systematic Spending and Saving—Its Use Educates for Responsibility.—There is another side to the question. The comments just made rest on the

assumption that instalment buying causes more spending and more extravagant spending than would otherwise occur. We have questioned this assumption previously in this study. We have pointed out that in some individual cases, instalment buying of consumers' goods, to say nothing of the producers' goods bought in this manner, actually leads to increased production. In still other cases instalment consumers' credit does not increase consumption at all as is commonly supposed to be the case. Then, too, was there ever a golden age when everybody paid cash? Was there not in the good old days a great deal of consumers' credit in the form of book credit or charge accounts or open accounts which was theoretically payable at the demand of the creditor, but which was actually paid, if ever, at the convenience of the debtor? Open account credit may have been more respectable than instalment credit, but its social and economic effects frequently were the same. There are those who believe that instalment buying is replacing to some extent the older forms of credit. Perhaps it is true, as its friends claim, that instalment buying is substituting a plan, an orderly method of payment for an arrangement which sometimes had little system in it. It is possible that the use of this kind of credit has a disciplinary value for the economically irresponsible and others. Hundreds of thousands of people are receiving an education in the use of credit, including the responsibilities attending its use. It may not take foresight to buy on time, but it certainly takes forethought to meet one's obligations when they are due. Since credit, as a rule, is not given to irresponsible persons, and since it is a thing so universally desired, there may be something to the point that it is causing some individuals, particularly those in the lower social and economic groups, to live in such a way that their credit will be always good with those who extend credit.

How the Actual Facts Concerning the Effects of Instalment Buying May Be Ascertained.—A careful, detailed, unprejudiced study of the incomes, expenditures, needs and saving habits of groups of individuals over a period of time and the effects of instalment buying on them would be of the greatest assistance in determining the actual effects of instalment buying on the habits and consequently the character of individuals. We have in mind investigations something on the order of those made by Rowntree in York, England, on Poverty, and Unemployment, and also the one made long ago by Booth on the Life and Labour of the People of London. Many difficulties would be encountered in the investigation, to be sure, but it could undoubtedly be made. There is still a great deal of secretiveness about instalment buying; also information which some people have is not worth much even when they are willing to give it. But on the other hand, we have spoken with numerous consumers, who have definite information and who possess intelligent opinions as to the effects of instalment buying upon their savings, and who are glad to give one the benefit of their experiences. The study would be practicable only by using the sampling method, say by studying intensively the people living in a number of city blocks or sections of rural communities, but if the groups studied were representative of the various social and economic groups in different sections of the country, the results would be invaluable. There is another way in which the question as to the effects might be settled; experience with the system on a large scale over a long period of time may make evident

its consequences to all. The beneficent results claimed for it by its friends may be so obvious as to "win over" those opposed to it. Or if disaster overtakes us, as the opponents of the system prophesy, then even its strongest supporters may be convinced of their folly. However, until the careful, detailed, unbiased studies such as we have spoken about are made, or until experience with the system on a large scale over a long period of time makes its effects evident to all, the arguments on the subject will be based largely on opinion rather than on fact, and consequently will be inconclusive.

XI. THE GENERAL CONCLUSIONS OF THE STUDY

Instalment buying has been a common practice in this country for the past fifty years. Even though such has been the case, there was comparatively little growth of the system until it was introduced into the automobile business about ten years ago. The great extension of the instalment business came in the years 1920–26, when the system underwent an enormous expansion in both volume of sales and number of industries affected. Exclusive of houses, life insurance, and stocks and bonds, all of which are sold on instalments on an extensive scale, it is estimated that approximately six billion dollars' worth of goods are now sold at retail, which is approximately fifteen per cent of all goods thus sold. It is estimated that the instalment debt outstanding *at a given time* is two and three-quarters billion dollars. Automobiles, standing far above all other commodities in importance, account for approximately one and one-half billion dollars of the instalment debt at the present time—more than all the other commodities put together. Household furniture is the second commodity in importance, accounting for approximately nineteen per cent of the total instalment debt. It is estimated that eighty per cent of all phonographs are sold on instalments, seventy-five per cent of washing machines, sixty-five per cent of vacuum cleaners, twenty-five per cent of all jewelry and the greater part of all pianos, sewing machines, radios and electric refrigerators. About one hundred and forty million dollars' worth of clothing is sold annually on deferred payments, but since the term of payments for this commodity is comparatively short, the amount of credit outstanding at one time is only about forty million dollars, which is one and four-tenths per cent of the total instalment debt. Whether instalment selling is increasing or not at the present time is a debated question. All the information which we have been able to gather on the subject points to the conclusion that the *total volume of instalment sales is still on the increase.*

The beginnings of the recent growth of instalment buying are to be found in the automobile industry. The manufacturers, although originally opposed to selling cars on credit, later encouraged it through a desire to increase sales and reduce the unit costs of production. The great growth since 1920 is due in part to the unused productive capacity existing in other lines of business besides the automobile industry during the depression of the latter part of 1920 and the year 1921. Other causal factors in the growth of the system are: competition between those selling the same kind of goods; competition between those selling different kinds of goods; advertising and high pressure salesmanship; the increased real incomes of the working

classes; the growth of finance companies; and the instalment plan of purchasing Liberty Bonds. An unusual explanation of the growth has been made recently by two writers who explain it as an accompaniment of a condition of "under-consumption" existing in our industrial system.

Previous to the recent expansion of the system, buying on the instalment plan, except houses and insurance, was practiced almost entirely by poor people. At the present time, all economic groups are using it on an extensive scale. Instalment buying is found in rural districts and small cities of all parts of the country as well as in the large cities. However, it is commonly supposed, and there is some evidence to support the belief, that, considered in relation to population or income, the larger increases have been in the large cities, and that in the smaller towns and smaller stores this means of granting credit has not had such exceptional growth.

Those who are inquiring into the soundness of the instalment system usually attach a great deal of importance to the character of the goods bought on the plan and the use to which they are put. Are they producers' or consumers' goods? Durable or quickly consumable? Necessities or luxuries? The granting of instalment credit for production purposes meets with little or no criticism. It is the granting of instalment credit for the purchase of what are generally classed as consumption goods that has brought forth severe criticism. Many people including some economists condemn instalment buying of consumption goods on the broad social and economic grounds that it is a detriment to the source of wealth, that is, it directs goods from productive to consumptive use and tends to use up the social fund of savings or at least prevents it from increasing as it otherwise would. However, in analyzing particular instalment transactions which are characteristic of large volumes of instalment buying, we found that *in some cases consumers' instalment credit does not increase consumption at all and in others it actually increases production.* Instances were presented which showed that in some cases producers' and consumers' loans have exactly the same economic effects as far as the increasing or decreasing of production and consumption is concerned.

In considering the question whether the goods bought on instalments were production or consumption goods, we found that motor trucks (eighty per cent of which are sold on instalments), motor buses, and taxicabs are producers' goods; also passenger cars when used for business purposes. Tractors, farm equipment and part of the improvements to buildings should also be classified as producers' goods. Except the articles just mentioned, all the other articles of importance bought on the plan, eleven out of a total of fifteen, are ordinarily classed as consumers' goods. Sewing machines, washing machines, and vacuum cleaners have thus been included under consumers' goods, and they are usually so classed; but it was pointed out that, considered with respect to the use to which they are put, the dividing line between these labor saving devices in the homes and the machines in factories is not very distinct. With respect to the durability of the goods, we concluded that clothing was quickly consumable, but all the other articles of importance were durable goods with the possible exception of automobiles. We did not attempt to classify the goods as necessities or luxuries, although this is considered an important distinction by some investigators. Any classification that might be made would not be

or by selling or buying government securities in the open market, to stabilize the general credit situation, it would seem that instalment credit, an element included in the general credit situation and at the present time bound up inseparably with it, could be controlled in exactly the same way. The difference between instalment credit and immense volumes of other kinds of credit, as far as the effects on price levels, production and overexpansion of credit in a business boom are concerned, is one of mere quantity rather than one of difference in kind. When the estimated volume of instalment credit is given in absolute numbers, as is usually the case, it looks large and *is* large, but when considered in relation to the volumes of other kinds of credit outstanding, it is small in comparison and one realizes that there is a possibility of concentrating too much attention on instalment credit, an admittedly dangerous element in the credit situation, to the exclusion of other elements equally dangerous if not more so. Overexpansion of credit helped to cause crises and panics before the instalment system on a large scale had been introduced and it would be the wise policy also to watch the expansion of those older forms of credit which are known to have helped cause fluctuations in business in the past and which will undoubtedly do so again.

It is interesting to note that, throughout the period 1920–26, the period in which the great expansion of instalment buying has taken place, there has not been any great increase in the general average of prices. And when one considers that the index numbers show a decline in the price level in 1926 over 1925, he feels that instalment credit is not plunging us headlong into crisis and depression via an increasing price level.

Another way, in addition to its effect upon price levels, by which instalment buying may help to cause the next crisis, is developing in the automobile industry a condition known as misdirected production or overproduction as some prefer to call it. Everyone agrees that the automobile business has been built up to its present position as one of our greatest industries largely through the instalment system; also that the maintenance of its position depends almost entirely upon the continuance of the system. The danger point in the situation lies in the fact that if the motor boom should collapse in any way, it may and probably would be followed by a collapse in some of the industries dependent upon the motor industry, and from these it would spread to industry generally.

There are grounds for believing that the next period of depression will be prolonged on account of the instalment selling of the present. On the other hand, there is the possibility that new extensions of credit will be granted in the latter part of the depression period, which will stimulate sales and hasten recovery. In other words, instalment selling may be the very device for hastening prosperity and lifting industry out of depression just as it is believed to have done in a number of lines of trade in the depression of the latter part of 1920 and the year 1921. For the exercise of control over the expansion and contraction of credit, one looks to the banking system—the banks as individual institutions as well as the Federal Reserve System. If the Federal Reserve Banks are able to control the general credit situation, as they are trying to do, and if they are wise enough to know the time or condition at which further extension of credit should be discontinued in a period of prosperity, it would seem that instalment selling under such

control might be a most useful device for lessening the extreme fluctuations of business. However, there is no getting away from the fact that instalment credit, like the older forms of credit, is a potentially dangerous phenomenon which *without control* will tend to help cause crises, panics and depressions, just as the older forms of credit have done heretofore. We do not believe, however, that this in itself is a legitimate argument against instalment credit; no one suggests that we eliminate producers' credit altogether simply because of the dangers lurking in its use.

Everybody wonders what will happen to the instalment system in times of unemployment. The system was put to a practical test under such adverse conditions about a year ago during the five and one-half months' strike in the anthracite district of Pennsylvania. We made extensive inquiry from the people living and doing business there as to whether their experiences were such as to make them lose confidence in instalment buying or such as to give them faith in it. The opinion was unanimous that everything in their experience was such as to indicate that selling on the instalment plan is a sound way of doing business. We do not attempt to generalize in any way on the experience of the anthracite regions; that is, we do not attempt to say what would happen in case of nation-wide unemployment such as occurs in a period of general depression.

An exceedingly important question in regard to instalment buying is that of its effects upon the characters of individuals. It is the view of some people that it is creating a generation of improvident people—spendthrifts. This opinion rests upon the assumption that instalment buying causes more extravagant spending than would otherwise occur. We have questioned this assumption in this study. There are others who believe that instalment credit has a disciplinary value. Its use inculcates habits of orderly spending and saving. It teaches respect for obligations and educates for responsibility. The difficulty of this question is in the fact that the same kind of instalment buying seems to affect different people differently. It is undoubtedly true that instalment buying causes some individuals to plan their expenditures and thereby leads to saving. But it is equally true that other individuals are led into extravagant spending by exactly the same set of circumstances.

This study will be concluded by an expression of *opinion*. What follows is not intended to be in any sense a scientific conclusion. It is mere opinion, but was formed only after conversation and correspondence on the subject of instalment buying with hundreds of consumers, dealers of all kinds, manufacturers, finance company officials and bankers; also after careful consideration of probable social and economic consequences. We believe that the instalment system performs a useful function in our economic structure and that it is here to stay. There are abuses which must be eliminated, such as extending credit without regard for any principles of sound credit. This kind of instalment credit brings disaster to both borrower and lender as does the unwise extension of every other kind of credit. Then, too, there are dangers lurking in the use of the system which must be guarded against. But we believe that the system is an important contribution to modern economic organization, and that in time to come it will be recognized as such, even by those conservative people who, at the present time, see little good in it.